

TRANSFORMING GOVERNMENT FOR THE 21ST CENTURY

HEARING

BEFORE THE

COMMITTEE ON
HOMELAND SECURITY AND
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

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WEDNESDAY, FEBRUARY 16, 2005

U.S. SENATE,
COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS,
Washington, DC.

The Committee met, pursuant to notice, at 10:04 a.m., in room SD-342, Dirksen Senate Office Building, Hon. Susan M. Collins, Chairman of the Committee, presiding.

Present: Senators Collins, Lieberman, Coburn, Lautenberg, and Pryor.

OPENING STATEMENT OF CHAIRMAN COLLINS

Chairman COLLINS. The Committee will come to order. Good morning.

This Committee often holds hearings exposing wasteful or even fraudulent government spending as part of its oversight responsibility.

Today, however, we are taking a broader look at what government should do and how government should deliver services in the 21st Century.

As the title of this hearing—Transforming Government for the 21st Century—indicates, we are not here to look at where we are or where we have been. This is about where we need to go and how to get there. It is about questioning the very premises of programs that have often changed very little from when they were first launched decades ago. It is about accountability and effectiveness.

All of us here can easily remember a time not very long ago when mention of the 21st Century evoked images of a future that was either dazzling or depressing. Now that we are in the 21st Century, we find that it is neither the Jetsons nor the Matrix.

The great changes we must deal with, the new threats that have emerged with the end of the cold war, the globalized economy, demographic trends, and the advancement of technology were underway long before Y2K.

The key to this hearing then is not the phrase 21st Century but the word “transforming,” one of the most dynamic words in our language. The great changes of recent decades and the myriad other changes they draw in their wake have been accumulating and accelerating over many years. In response, government has all too often moved at what can charitably be described as the speed of government.

The GAO report we will discuss today is an excellent place to begin this transformation and I want to commend the Comptroller General and his staff for embarking upon this study. Like this Committee, the GAO is going beyond its customary role by opening this important discussion.

The title of the GAO report that we are releasing today is "21st Century Questions: Reexamining the Base of Government."¹ This report is not an exercise in imagining the future. It is the direct result of the GAO's fiscal oversight duties and the sobering realization that our government's current fiscal policies on both the spending and the revenue sides of the ledger cannot be sustained in the future we have entered.

Baby boomers' retirement, health care, homeland security, national defense, environmental protection and the increasing demands in such areas as energy, transportation, and education are but a sampling of the forces that are relentlessly leading our Nation to mounting deficits.

As this report observes, the concern is not with deficits that result from extraordinary events such as terrorist attacks or short-term economic downturns. The concern is with long-term escalating and persistent deficits that will diminish the standard of living and the security of Americans for generations to come.

This report is presented in the form of questions. They cover virtually every function of the Federal Government. They range from broad policy objectives to specific inquiries. For example, how best to allocate resources across our increasingly integrated yet still discrete Armed Forces? Can transportation grant programs be restructured and consolidated to encourage the creation of efficient intermodal systems? Given the great advances in communications, are regional offices still the best way for Federal agencies to serve the public? Is having 44 job training programs spread across 9 agencies the best way to help our workers adapt to the changing economy? These are just some of the questions that GAO raises.

This question format is appropriate because it is Congress and the administration that must provide the answers. There are more than 200 questions and they cover a lot of territory. But the overall issues can be summed up by these three questions: First, what kind of government would we create if we were starting from scratch today? Second, since we cannot ignore existing obligations, needs, programs and systems, how can we transform government without disrupting its ongoing functions? And third, and perhaps the most perplexing question of all, how can we change government in spite of the entrenched interests that are committed to resisting any change?

All of this sounds daunting. We should be encouraged, however, because we have done it before. The structure of our military today could not have been imagined during World War II and yet it has been transformed dramatically. Program reexamination and restructuring are nothing new, Social Security in 1983, tax reform in 1986, and welfare reform in 1996 are just a few examples. In the aftermath of September 11, we consolidated 22 Federal agencies

¹ A copy of the report, "21st Century Challenges: Reexamining the Base of the Federal Government," GAO-05-325SP, February 2005, is retained in the files of the Committee, or may be obtained through the U.S. Government Accountability Office.

into the Department of Homeland Security. And more recently, enacted sweeping intelligence reforms.

It is time we applied our proven ability to innovate and our knowledge of transferring the government to the entire spectrum of government itself.

If you type the words “challenges of the 21st Century” into an Internet search engine, you will get tens of thousands of results. From hospitals to the hospitality industry, from the news media to art museums, from the governments of great economic powers to rural school boards. It seems that every organization is reexamining what it does and how it does it in the light of this new millennium.

Look a little closer and it is clear that there is nothing intrinsic about the dawn of the 21st Century that makes reexamination necessary. The striking new look our calendars took on 5 years ago was merely a reminder to many that a reexamination is long past due.

One of the great thinkers on the subject of organization and management is Peter Drucker, a Presidential Medal of Freedom recipient in 2002. His pre-millennium book, “Management Challenges of the 21st Century,” includes a chapter entitled “Creating Change: The Leader’s Task.” Here is a quote from that: “Innovation,” he said, “is not a flash of genius. It is hard work.”

So today we are embarking on the hard work of the innovation and transformation. This hearing and this report will get us started. And again, I want to commend the Comptroller General for undertaking this vitally important task.

Senator Lieberman.

OPENING STATEMENT OF SENATOR LIEBERMAN

Senator LIEBERMAN. Thanks very much, Madam Chairman, for an excellent, thoughtful opening statement. A great one line there, not your most substantive point, but that the 21st Century turned out to be neither the Jetsons nor the Matrix. I thought that was good.

Mr. Walker, welcome. This is a very important hearing and I thank the Chairman for convening it. The truth is the room ought to be packed and the Nation ought to be watching. Maybe some are watching through that camera.

But you are playing a role as a kind of a Paul Revere. And this time it is not the British that are coming. It is genuine fiscal failure of the American Government, which will make the future of our children and grandchildren, and those of us who are lucky enough to be alive, in the not too distant future, much less than we want it to be.

Today Mr. Walker, who has done such an extraordinary job at the helm of the now quite appropriately renamed Government Accountability Office, is going to take us beyond the day to day, which is to say the kinds of reviews of ongoing Federal programs that GAO does such a great job at, to look over the horizon at the enormous fiscal, social and national security obligations that the Federal Government will face and, on the current path, will not be able to handle.

This stuff is riveting. Madam Chairman, I had the opportunity—it is hard to describe it as an opportunity—to hear Mr. Walker do something like this to another group a while back. I was just grateful when it was over that all of us were still able to rise from our chairs and leave the room because honestly, it goes at the heart of America's normal optimism and particularly hopefulness about the future.

Maybe part of what it says to us is that we have been really optimistic and hopeful about the future, but we have not figured out how to pay for it. As a result, some of the consequences are startling. These charts that Mr. Walker will show us soon, says to us that by 2040, which is not that far from now, 35 years, just on the current path that we are on, and not extending the current tax provisions, including tax cuts, the revenue that at the Federal Government is likely to generate will cover net interest on the debt, Social Security and most of, but not all, of Medicare and Medicaid. Nothing for what is the rest of the Federal Government, and a lot of stuff that a lot of people really care about: Education, environmental protection, and, I should have started at the beginning, national security, homeland security—the first responsibility of government—to provide for the common defense.

And as startling as that is, and I feel like we should be screaming this out, if you extended the otherwise expiring tax provisions, when we get to 2040, 35 years from now, with the revenue that will be produced, all we are going to be able to pay for is the projected interest on the debt. I laugh with a certain sense of alarm. No money for Social Security, Medicare, Medicaid, or any of the rest of the Federal Government.

The only way we are going to begin to deal with these is by beginning to deal with them, and as soon as possible. We are going through, with the President's leadership if you will, he is challenging us to do something about Social Security because it is not sustainable in the long run.

What Mr. Walker's statement to us today says, is that the Federal Government, as we know it, is not sustainable in the long run. As much as we all care about Social Security, Medicare and Medicaid, which we surely do, and we have to deal with the enormous looming gaps in funding for those programs that are so critical to the quality of life of tens of millions of Americans, we also care about the rest of the Federal Government—national security, homeland security, and education. I repeat housing aid, environmental protection, and national parks. You could go on and on.

We have to face this and we have to tighten our belts. Obviously, one of the consequences of not doing so is that we continue to increase the amount of money we borrow. At some point this puts us in real jeopardy in terms of our fiscal credibility, perhaps leading to a precipitous slide of the dollar with all of the adverse consequences that we will have for our economy ultimately and probably leading to the loss of an enormous number of jobs in our country.

But also, of course, we become beholden to foreign purchasers of our debt. And in some sense, thereby lose some of the independence and authority that we gain as a result of our extraordinary American military.

The final point that I wanted to make is that all of this reminds us, I hope it does, that our budget process has broken down here in Congress. A series of checks that were set up to try to limit spending, or to put it another way, to make sure that spending and revenues balance, have just collapsed. There is not a lot of rational focused review of spending as we all know. The last 3 or 4 years we have had big omnibus appropriations acts come through that frankly do not receive much of attention from individual members. We need to get back to a better system.

I say this with a certain grain of salt, but I have felt that we ought to go to a system of present value accounting so we can get a real long-term sense of what our obligations are as businesses do. I say that with a grain of salt this morning because just going to 2040 is alarming enough and ought to generate action.

I go back to what I said at the beginning, David Walker is extremely credible for all that he has done for our government. He is now saying to us, this country is in danger. We have met the enemy and it is us. Therefore, it is up to us to do something about it.

President Bush, in his State of the Union address recently said, "we will not deny, we will not ignore, we will not pass along our problems to other Congress', other presidents, and other generations."

And now, we all need to honor that promise and work together to make sure that the events that Mr. Walker projects this morning do not happen. Because if we continue on our current path, they will happen and America, this beloved country of ours, will be much less than we want it to be for our children, our grandchildren, and for the world. Thank you.

Chairman COLLINS. Thank you, Senator. Senator Coburn.

OPENING STATEMENT OF SENATOR COBURN

Senator COBURN. Madam Chairman, and Mr. Ranking Member, I apologize for being late.

I just came from the Indian Affairs Subcommittee meeting where they are talking about budget items. There are 10 times as many people there protecting the turf as there are here looking at the long run. I must associate my remarks with yours. Most of what you just said is what I ran on just 4 months ago. I think it is really important and I am so pleased to have the opportunity to chair a Subcommittee. And I hope both our Chairman and Vice Chairman, as ex-officio Members of that Committee, will be involved. We have to do something.

My heartache is that things will continue as they have been. It does not matter whether it is Democratic leadership or Republican leadership. The powers that be, to protect themselves and their interests, deter effective oversight. And we have not done it. We have not lived up to our responsibility as a Congress to do the right oversight in each and every area.

I am reminded back: The Grace Commission stipulated that over 20 percent of everything that the government spent was either defrauded, wasted or abused. And yet, of all of the recommendations that were brought forth by that independent commission, two out

of every three that were recommended were never even looked at by Congress, never even considered by Congress.

Also, looking at the chart, and having read a book which I think both of you are familiar with, "Running on Empty," by Peter Peterson, and a lot of his numbers come from your office, sir. The time to do something is now, not later. The time to be aggressive is now, not later.

As I look at the numbers that are spent on Medicare and Medicaid—as we see that number from today triple—one out of every three dollars that is going to be spent on Medicare and Medicaid in 2040 is going to be related to diabetes. And yet, the administration is not leading on that. Nobody is leading on prevention. We know that one of two people who will ultimately get diabetes could be precluded from that by just a change in the exposure to the foods they eat as a child. High fructose corn syrup now has been held in two different separate studies to double your lifetime risk for diabetes, unrelated to obesity. And yet we have no leadership in our country on prevention. Prevention is the thing that is going to bring those numbers down.

We are starting to see some leadership in terms of best practices in terms of Medicare and Medicaid, but it is very minimal and not aggressive enough.

I look forward to your testimony. I believe it is incumbent upon us, if we really care about the future, and if we want to honor the heritage that was given to us, that we fulfill our responsibility of being aggressive in terms of oversight. I hope to be a part of that. Thank you.

Chairman COLLINS. Thank you very much.

I think we should address you as Dr. Coburn in addition to Senator Coburn. I was just saying to Senator Lieberman that I founded the Diabetes Caucus in the Senate several years ago. And at that point, one out of four Medicare dollars were being spent treating diabetes. I remember bringing up that issue at Tommy Thompson's confirmation hearing because an initiative in that area would clearly translate not only in improved human health and lives but a substantial reduction in health care dollars. So I appreciate knowing of your interest in that area.

Senator Lautenberg.

OPENING STATEMENT OF SENATOR LAUTENBERG

Senator LAUTENBERG. Thank you, Madam Chairman and I apologize for my lateness. I should have played follow the leader. I saw Senator Lieberman going to another committee that we both sit on, and he had advance notice that that was not going to be held for 2 more weeks. It took me awhile to discover that I was the only one in the room.

Senator LIEBERMAN. Senator Lautenberg, when I told him that, said he would still go there to sit down so he could be the first to speak when the hearing started. [Laughter.]

Senator LAUTENBERG. In any event, Madam Chairman, we have done a fair number of things together after we got through the getting used to your kind of start. But in any event, important matters come before this Committee and I am pleased to see your leadership on yet another important matter.

Holding this hearing on government accountability, it causes us to look at things, I think, in kind of a different way. The telltale, if you will, is the budget. I have listened carefully to Senator Coburn's comments, having the background that he has as a physician, has special resonance.

But when we look at the cost increases in programs like Medicare and Medicaid and what might happen with Social Security if we do not deal with the problems there. And I think of the number of people who are so dependent on these programs. And those numbers obviously have grown, much to my personal delight as one can attest to.

My father died when he was 43, having contracted cancer in an occupational position that was dangerous to his health. But my father, who was 43 when he died, took 13 months to die. My mother was 36 years old when he finally passed away. In addition to the grief that came from losing a loved one, the enormity of the bills that were owed, doctors, hospitals, you name it. There were not the sophisticated chemicals or drugs that we have today to help him get through. But the costs mounted.

I had enlisted in the Army with not very good prospects in sight, and my ability to go to Columbia University at a cost that was reasonable for even this little family of ours meant an awful lot. I am not sure all of my Republican colleagues would agree that this was a benefit to the country but here I am, having created a business and an industry, the outsourcing industry. I am credited with being a pioneer in that industry.

I look at the benefits of those programs and the embarrassment that my dad had when he had to take a job with WPA. His dignity was hurt but not so much that he could resist the few dollars a week that he could make and help my mother and my little sister and me.

We want to do these things and get them into line. But I think the starting point has to be examining the programs fully and realistically and kind of understand where the government fits. As I look at some of the commentary that has been available to us, the statement from Grover Norquist who is President of Americans for Tax Reform. And he said their goal is to shrink government to the size where it can be dragged into the bathroom and drowned in the bathtub.

When I think of the people who are dependent on Medicaid or disability payments from Social Security, what a terrible thing it would be to eliminate those programs when we consider, Madam Chairman, the fact that my good fortune in business got me to a point where I can afford to take good care of my family and certainly did not need a tax break.

If that tax break comes at the cost of eliminating someone from Medicaid or a disability program, someone who desperately needs medical attention and health care, and we start looking at the budget first and saying OK, I think we have to look at the thing in its entirety.

I commend you for bringing the question up, and Mr. Walker for his exceptional and balanced service to the country. We are glad to have you here and to be able to discuss this.

Sorry I was late and sorry I ran over time here.

Chairman COLLINS. Thank you.

I would now like to welcome our distinguished witness to the hearing. David M. Walker became the seventh Comptroller General of the United States and began his 15 year term on November 9, 1998.

As all of my colleagues have indicated, we have worked very closely on this Committee with the Comptroller General. He has done an outstanding job in leading the Government Accountability Office and in producing fact-based, nonpartisan reviews of government programs and operations. So we very much look forward to hearing your testimony today.

Thank you, Mr. Walker.

TESTIMONY OF HON. DAVID M. WALKER,¹ COMPTROLLER GENERAL OF THE UNITED STATES, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. WALKER. Thank you, Chairman Collins, Ranking Member Lieberman, and other Senators for being here today.

I appreciate the opportunity to unveil GAO's latest report: 21st Century Challenges: Reexamining the Base of the Federal Government.² I understand that each of you have a copy of the report. It is being unveiled at this hearing.

I want to thank this Committee, and the Chairman and Ranking Member in particular, but all of the Members of the Committee for your support of this effort and for your recognition of the strategic importance of the issue which we are going to discuss today.

It is somewhat ironic, as one of you mentioned, there are a number of competing hearings going on right now. And they all involve important players and topics of varying importance. But they are all focused on the here and the now. There is not enough focus about the future.

I would respectfully suggest that the contents of this report and the subject of this hearing is of more strategic importance and long ranging significance to this country than probably any other hearing that will go on today in either body of the Congress.

So I want to thank all four of you for being here and maybe others will come and join us from time to time.

The good news is that this is just the beginning. This is the first step of what is likely to be a long road involving this Committee, other committees, and various other parties over many years in order to address our current situation.

As you know, Senators, the GAO is in three lines of business: Oversight, insight, and foresight. Today's topic is a foresight topic, with significant oversight and insight implications.

I would like to note that it is important to know at the outset why we produced this report and why we produced it at this time. First, as you know, while most of our work is oversight and insight, we have been doing more foresight related work in order to help the Congress be in a position to address current and emerging trends and challenges before they reach crisis proportions.

¹ The prepared statement of Mr. Walker appears in the Appendix on page 29.

² A copy of the report, "21st Century Challenges: Reexamining the Base of the Federal Government," GAO-05-325SP, February 2005, is retained in the files of the Committee, or may be obtained through the U.S. Government Accountability Office.

In doing that, we have drawn upon the extensive amount of work that we have done for the Congress over the years, over 90 percent of which is either mandated by the Congress or requested by the Congress. We also looked at our strategic plan for serving the Congress, which is prepared in conjunction with the Congress.

And candidly, the reason that we are doing it now is that if you look at the results of the financial statement audit for the U.S. Government for September 30, 2004, fiscal 2004 was a very bad year. We increased our liabilities and unfunded commitments by over \$13 trillion in 1 year. They went up from \$30 trillion to over \$43 trillion in 1 year, largely due to the Medicare prescription drug benefit. And we had a large unified deficit, of which less than 25 percent had anything to do with Iraq, Afghanistan, and incremental homeland security costs. And yet, we had the strongest economic growth of any major industrialized Nation last year, and have not been in a recession for several years.

But as Chairman Collins mentioned, the important point is not as much what happened last year or what is going to happen this year. The important point is where are we headed? I think that this report makes it very clear that, based upon our work, we are headed for very troubled waters if we continue our current course. As a result, we must change course or risk doing irreparable harm to our ship of state as well as to the future security, standard of living and choices that will be made available to our children and grandchildren.

If I can, what I would like to do is show you some of the highlights in the report. I would respectfully request, Chairman Collins, that my entire written statement be included in the record, if it is OK with you.

Chairman COLLINS. Without objection.

Mr. WALKER. Thank you.

Understand at the outset, before I go through this, the report notes that we are on an unsustainable fiscal path. We must fundamentally review and reexamine what the Federal Government does, how the Federal Government does business, and in some cases who does the government's business. It must be comprehensive, involving discretionary spending, mandatory spending and entitlement programs, as well as tax policies. That is the premise.

It is also important to note that a significant majority, if not a vast majority, of the Federal Government, is based upon conditions that existed in the 1950's and the 1960's. Most current Federal Government policies, programs, functions, and activities have never been subject to fundamental review and reexamination since they were initiated. We have been layering and layering and layering with the presumption that the base is OK. Not only is it not OK, it is unsustainable. It is important to recognize that reality.

If I can, this is the first chart.¹ I understand that all of these have been provided to you. They are also contained in the report.

The first one is based upon CBO's baseline projection. We do not compete with our sister agency. They do a very good job with what they are asked to do. It is also based upon the best estimates of the Social Security and Medicare Trustees—of which I used to be

¹ The charts submitted by Mr. Walker appear in the Appendix on pages 62 to 66.

one from 1990 to 1995—regarding what the cost of these programs will be.

But there are three key assumptions that underlie CBO's projection and are used as an input into this first GAO simulation, that I would respectfully suggest are totally unrealistic. First, no new laws will be passed. Second, discretionary spending will grow by the rate of inflation. And third, that all tax cuts will sunset. And actually, let me add a fourth one, that AMT, the alternative minimum tax, will not be fixed. Those are four key assumptions which, by the way, CBO is required by law to make. And I would respectfully suggest those are unrealistic assumptions and so this is an optimistic scenario.

But even under this optimistic scenario, you can see that we face large and growing structural deficits due primarily to known demographic trends and rising health care costs.

If we can, let us take the next chart.

Senator LIEBERMAN. Excuse me, for a quick question. What kind of economic growth do the CBO numbers assume for the country over that period of time?

Mr. WALKER. On the out years they assume economic growth, I think, of about 1.8 to 2 percent real GDP growth. However, I will provide the exact number for the record. The reason, primarily, is because of slow work force growth, because we have a significant reduction in work force growth that is expected to continue. The bottom line is, let us hope we can get better economic growth than that. But I think you will see from the next chart, there is no way we are going to grow our way out of this problem, reinforcing the importance of today's report.

The next chart. There are only two differences between this simulation and the last one, as Senator Lieberman touched on. Discretionary spending grows by the rate of the economy rather than inflation. And, that all tax cuts are made permanent.

I am not saying that is good, bad, or indifferent. I am just giving you the numbers. The fiscal future on this scenario is that the Federal Government will be able to do little more than pay interest on our large and mounting Federal debt. In fact, the simulation model blows up in the 2040's under this scenario.

These are obviously both unacceptable paths. A likely scenario is probably somewhat in between these two bookends. Both of which are unacceptable and unsustainable. We need to do something about it. Next chart please.

This report attempts to take the strategic themes that are in our strategic plan for serving the Congress, which have been developed in conjunction with the Congress. These are themes that have no geopolitical boundaries. They are global trends. They are trends affecting the Federal, State, local governments, the public sector, private sector, and not-for-profit sector. Long-range fiscal challenges, I have shared with you some of those. Changing security threats in a post-cold war environment and increasing global interdependence. The changing nature of the economy, moving to a knowledge age rather than an industrial age. Demographic shifts, rapid changes in science and technology and a variety of quality of life issues, such as education, work, family, the environment, and urban sprawl. Also changing governance structures where more

and more issues have to be handled on a global basis like fighting infectious diseases, and protecting the homeland. These have to be fought on a global basis, not just here at home. As well as more and more issues have to be dealt with Federal, State and local as well as public, private, and not-for-profit sector involvement.

Next chart please.

We build off of our strategic themes because they are grounded in our work for the Congress and in our strategic plan that has been accepted by the Congress. We have a number of generic questions in the report.

Such things as when did we create this program or policy? Why did we create this program or policy? What were the conditions that existed at the time? What were we trying to accomplish? How do we measure success on an outcome basis? Are we successful based upon such measures? How has the world changed since then? Should the program be reviewed, reconsidered, revised, re-engineered or eliminated even based upon those changes? What priority is it for today and tomorrow? Are we using best practices?

These are very basic questions but I would respectfully suggest they have not been asked and answered for a vast majority of the Federal Government.

And it is not just the spending side. It is also tax preferences. In many years, the total cost of tax preferences exceeds total discretionary spending. And yet, they are off the radar screen. Total tax preferences in many years exceed total discretionary spending, the biggest and the fastest-growing tax preference being health care. Next chart please.

We then look at these themes, which are on the horizontal axis, and we looked at a vertical axis—such as defense, education, transportation—these are self-explanatory, to see how these trends converge with the different departments and agencies and functional areas within the Federal Government. Typically, committees are structured on the vertical axis rather than from a horizontal dimension. This Committee, fortunately, has a lot of horizontal responsibility and authority.

Then, next chart, what we then attempted to do is to pull the vertical and horizontal dimensions together to show how they interrelate. For example, when you are talking about demographics, you have to talk about things like Social Security, the labor force, private pensions, disability programs, and health care. Next chart please.

When you are talking about increasing global interdependence, you have to talk about such issues as financial regulation, domestic subsidies, and the structure of our tax system. Next chart please.

When you are talking about a knowledge-based economy on which our competitive posture and economic growth is based upon having the best people, we cannot compete on wages. We have to compete based upon productivity, quality, and innovation.

On this dimension, you have to look at immigration policy and workforce policy and retraining, research and development and whether or not we are generating enough personal savings to be able to finance our own needs. As you know, and I think Senator Lieberman was the one that mentioned it, we are relying to an increasing extent on foreign investors to finance our consumption and

our deficits. To a certain extent, we cede part of our own destiny by doing that. That is not risk-free, by doing that. Next chart please.

Changing security threats and defense resource allocations. What type of force do we need? What type of footprint do we need? What type of information sharing must we have in order to maximize deterrent and respond to adverse events? Next chart please.

And then from a governance standpoint, issues like the need for national performance indicators. Believe it or not, this country does not have a strategic plan. It does not have a performance plan. And it does not even have a set of key national indicators to measure where we stand, how we are doing over time, and how we compare with others. Economic, security, safety, social, and environmental indicators. We do not have them.

We are working with the National Academy of Sciences and the OECD to try to help further the development of such standards. They could help to inform a strategic plan, enhance performance and accountability reporting, and provide a basis for this much-needed fundamental baseline review and reassessment of the Federal Government.

In summary, there is little low hanging fruit here. But there is tough work that needs to be done. No one single approach will address all of our challenges. Many players will have to be involved over a number of years in order to address them.

I would respectfully suggest this could take as long as a generation to effectively address all of the questions. But we must start now because time is working against us. And unlike investments, where the miracle of compounding works for you, the miracle of compounding is working against us right now because debt on debt is not good.

And last, I would respectfully suggest that our country, children and grandchildren are counting on us to not just focus on today but to also be good stewards for tomorrow. And that ultimately, it is not about numbers. It is about values. What type of country do we want to have in the future? What type of country do we want to hand over to our children and grandchildren? What choices do we want them to be able to make as to what they feel the proper role of government should be in the future? How much flexibility are we going to provide them?

I would conclude by saying, Chairman Collins, that you mentioned a very important word. And I think there are three that are going to be really important here as we move forward, both for the Legislative Branch and the Executive Branch. First, courage. the courage to take on these issues. There are a lot of people who are vested in the status quo. Change is really tough, especially for a monopoly like government that does not change very much.

Second, integrity. People with integrity who speak the truth, state the facts, and tell it like it is. People who want to find out what is working and what is not working in order to make informed choices.

And third, innovation. We are going to have to think outside the box. What are we trying to accomplish? How best to accomplish it? What is the proper role for the Federal Government? Where should the Federal Government be involved because the private sector

cannot or will not do it, the other levels of governments are not doing it and therefore we are in a unique position or there is a need for us to be able to do it? And how can we partner more? And how can we focus more on achieving positive results and concrete outcomes? Because in many cases, we do not know what results and outcomes we are getting, from the tax preferences, for the discretionary spending, or the mandatory spending.

As you know, more and more of the budget is on autopilot. Over 60 percent of the budget is on autopilot and it is going up every year.

Thank you, Madam Chairman. I appreciate you allowing me a little bit of extra time because this is an important topic.

Chairman COLLINS. Thank you so much for an excellent statement and overview.

I think most Members of Congress are keenly aware of the fiscal challenges that you describe, although when you see the charts, it is even more startling in the out years. And in many ways, we are like a person who knows that he needs to go on a diet and yet just cannot seem to start.

That makes me wonder whether we need changes in the budget process to help us exercise the kinds of fiscal discipline and make the hard choices that need to be made.

Could you comment on whether or not there are some specific changes to the budget process that GAO believes would help impose the kind of fiscal discipline that is lacking now?

Mr. WALKER. Yes, I can. And I think that is an excellent point. Many of the controls and safeguards that existed in the budget process have now expired. Some of the things that we believe that the Congress needs to consider include reasonable spending caps, PAYGO rules that apply on both sides of the ledger, meaning on the spending side and the tax side. Realistically, if you are trying to address the bottom line, you should not exempt one side of the ledger.

Having also some type of triggers for mandatory spending programs. Being able to get a better handle on the total commitments that we have already. For example, I mentioned to you the \$43 trillion number. That is the estimated total liabilities and commitments as of September 30, 2004. Let me compare that number to another number that might shock you. The total estimated net worth of every American, Bill Gates down, including home equity is \$47 trillion. And we currently have total liabilities and commitments of \$43 trillion in current dollar terms.

We are obviously not going to be able to deliver on all of our current promises. We are going to have to restructure.

We need to think about the discounted present value cost of major spending and tax proposals before they are enacted into law. And as a supplement to or a substitute for the cash flow items that we get right now for 1 year, 5 years, and 10 years.

We also need to try to get a sense as to what the intergenerational impact of some of these burdens might be. As you know, right now there are a lot of things in the budget, a lot of things in the law right now whose costs escalate right beyond the 5 or 10 year horizon on both the spending side and the tax side. And because of known demographic trends, we need to think about the

longer-term affordability and sustainability of existing policies and programs.

There are other things that I think should be considered, as well. Some people have advocated biennial budgeting. That is not a panacea by any means. Some people believe that if you had biennial budgeting, that you would spend more time on oversight. I would like to think that is the case, but I would not want to bet a whole lot of money on it.

Frankly, we have been doing supplementals every year, and are likely to do supplementals for the foreseeable future. So that provides a safety valve to be able to deal with issues if you go to biannual budgeting.

So these are some of the areas, but I absolutely agree, Madam Chairman, that we absolutely have to do something with regard to the budget process. It is fundamentally broken.

Chairman COLLINS. I want to switch to one of the specific issues that you have highlighted in your report and that is the fractured approach that the Federal Government applies to job training programs. I believe GAO indicated that there are some 44 job training programs spread across nine different agencies. This matters to a State like mine, which has lost a lot of manufacturing jobs in the past decade. I know there has been some frustration about the delivery of job training programs in my State.

On the other hand, we passed the Workforce Investment Act to try to coordinate those programs. Did that not work? What is your assessment?

Mr. WALKER. I think that was a positive step in the right direction but I think there is more work that needs to be done. Candidly, job training is just a subset of a much bigger challenge. For example, you properly point out that we have noted that there are 44 different programs among a number of different agencies. I recently found out, for example, there are over 20 Federal agencies involved in financial literacy. We recently had a related forum over at GAO. We invited a number of people. Many of them did not even know they were in the business.

One of the things that we have to do is we have to get better visibility horizontally. In other words, take particular areas, job training, food safety, financial literacy, you name it. How many different players do we have on the field? What are they doing? Why do we need this many? Are they doing things consistently and in a nonduplicative and integrated fashion?

I think one of the things that we look forward to working with this Committee and others on is how can we start looking at things not just vertically, which government has done for years and always will, but also horizontally?

Chairman COLLINS. Let me just quickly ask you one final question for this round.

As I read your report and the 200 questions, it is almost overwhelming to know where to begin to tackle the programs and policies that you outlined. Your report is a great help in giving us the overview. But as a follow up, I wondered if GAO would be willing to apply the reexamination criteria that is set out in Table 1 of your report to the programs within the Federal Government and respond back to us with a list of programs that you believe should

be reexamined first? If you could help us narrow the universe of programs that might be most fruitful for us to examine in-depth. Would that be a project that GAO would be willing to undertake?

Mr. WALKER. I would be happy, along with the other GAO professionals, to work out something with your staff that can be done within a reasonable amount of time. As you might imagine, trying to apply those criteria to all Federal programs is something that would take years to do.

So I think what we might be able to do is to take particular areas that you and other Members might have particular interest, like homeland security information sharing. To what extent do we have multiple programs across government dealing with the same type of issue? What about regions? Do we need as many regions as we have? And other topics, and to try to come back with something for your consideration.

Chairman COLLINS. Thank you. Senator Lieberman.

Senator LIEBERMAN. Thanks, Madam Chairman.

I want to go back, Mr. Walker, to something you said at the end of your opening remarks, which is that more than 60 percent of the spending of the Federal Government is currently on autopilot. That is a reality that is clearly not understood or known by most of the American people. I would dare say that a lot of Members of Congress have not focused on that reality.

It struck me last year, when once again we were unable to complete, because of the breakdown of the Congressional budget process, each of the separate 13 appropriations bills. So it was all lumped together in an omnibus bill at the end. It came to somewhat over \$800 billion. That is a lot of money, obviously. But it turns out to be about a third of the full spending of the Federal Government because the rest is interest on the debt, Social Security, Medicare, and Medicaid, particularly.

It speaks to our problem, and why the focus in this session on the sustainability of Social Security over the long run is just the beginning, and why it is so important that we figure a way together to deal with that, to give both the public, the financial markets and ourselves the confidence that we can go on and deal with some of the longer-term problems of broader Federal Government sustainability that you talk about.

Deficits in the Federal Government are nothing new. So my first question to put this in the context, because you, in previous years, and other comptrollers general, have come before Congress and warned about impending long-term unsustainability.

To the best of your knowledge, is the circumstance we are in today, that you have portrayed, just a little worse than it has been for a long time? Or is something much more grave occurring?

In other words, is this the worst ever as a Comptroller General looks forward to the fiscal future health of the United States?

Mr. WALKER. I do not know that I would be in a position to say is this the worst ever. What I would be able to tell you is that fiscal 2004 was a very bad year. With a \$13 trillion increase in liabilities and unfunded commitments in 1 year, going from \$30 trillion to over \$43 trillion in 1 year. And the large current deficit, which obviously is not the primary problem. Where we are headed is the primary problem. But with the current deficit, less than 25 percent

of it had to do with Iraq, Afghanistan, and incremental homeland security costs. And yet, we had strong economic growth and we have not been in a recession since November 2001. So those are warning signals.

I am a member of the Sons of the American Revolution. Both my wife and I have family members who fought and died in the Revolution. I remember Washington's words of wisdom, "the most important personal attribute is courage. And the most important institutional attribute is fiscal responsibility." We need to heed Washington's words of wisdom.

Senator LIEBERMAN. Let me ask you about some of the responses institutionally. As you know, I have been interested in present value accounting for the Federal Government activities. I suppose, in one sense, people would ask why, because the news is bad enough with cash value accounting. But we ask businesses under ERISA to use present value accounting. Social Security trustees are now using it.

I believe I know you are supportive of this, but I wonder if you could just talk about why it would help to go to present value accounting as a supplement to cash value accounting?

Mr. WALKER. First, we have present value accounting for financial reporting. Unfortunately, not enough people look at the financial statements of the U.S. Government.

I would respectfully suggest that while they were issued in record time this year, they were issued on December 15, only 76 days after the end of the fiscal year, which is record time, which is a real accomplishment, not many people have probably read those financial statements, including the disclaimer of opinion by GAO because of the poor state of financial records at DOD and elsewhere. But also because the emphasis paragraph that I put in, noting that we are on an unsustainable fiscal path.

But we have present value accounting for financial statements. And the numbers that I gave, the \$43 trillion, you can get those out of the annual report. The problem is you have to look in several different places and pull them together.

And so I am working with the Secretary of the Treasury, the Director of OMB, and the Federal Accounting Standards Advisory Board to enhance financial reporting.

But in addition, on the budgeting side, which I believe you are touching on, I think as a supplement to—not a substitute for—the cash flows, we need present value numbers for big ticket spending and tax items to be considered by the Congress before it acts. You did not have that when you passed the Medicare prescription drug bill. The debate was about whether it was going to cost \$395 billion, which is what CBO said, or \$534 billion, which is what the Medicare's Chief Actuary said?

Roughly 3½ months after Congress passed that bill, the Medicare trustees came out and said \$8.1 trillion in current dollars. That number should have been on the table. It should have been discussed and debated because I think a lot of people are shocked by it today.

Senator LIEBERMAN. My time is up but I look forward to a second round.

One thing that number would have probably inhibited is the number of people who described the Medicare proposal as cheap. In other words, too cheap, that it did not cover enough. It just suggests what the cost is of the commitments that we make.

And we do this all with good intentions. This is another part of the American character. We are good people. We want to take care of each other.

But one of the great traditional American values also was to pay your bills. The Federal Government is not paying its bills.

Thank you, Madam Chairman.

Chairman COLLINS. Senator Coburn.

Senator COBURN. Madam Chairman, I think one of the great traditions of Congress is fixing the wrong problems. And I think that is what they did with the Medicare drug bill. That happens to be my personal opinion and I was not here at the time.

Following on what Senator Lieberman said, the real problems we face, because of the lack of discipline in Congress—and see if you agree with me—we have a demographic shift, aging population. We have an unsustainable population birth rate. In other words, it is below reproduction of our population. We have exported a vast majority of our basic manufacturing tasks. Fourth, is we have not restrained spending.

Whether you want to talk about tax cuts greater or less than 19 percent of consumption or 22 percent consumption of GDP, the fact is that with those basic demographic changes, if they are not changed, we will not fix the problem.

We are not going to change the aging. It is doubtful we will have much influence on the birth rate. So we have really two options. One is to do what you suggest and really have a systematic review. The other is to look at the export of our manufacturing that we seem to be wanting to give to the rest of the world through our open trade but nobody else's open trade policies.

How much of our financial problem has to do with the undermining of our basic manufacturing industry in this country, in terms of jobs? Much as the Chairman has lost, Oklahoma, I think, lost 60,000 manufacturing jobs in the last 6 years.

If we want to try to tackle this problem, and I think right now you can see the number of people here, there are not many people interested in this problem. So, is it realistic to think the Congress is going to address it? And, if we decide to address it, how do we leverage that? How do we expand? You're talking about a generation. We can't wait a generation to fix these problems.

Mr. WALKER. Several comments. First, a number of the items that you mention are real issues. They are real problems. There are others, but those are real problems.

Second, someone said demographics are destiny. And demographics are a major factor contributing to our long-range problem. Those are known. They are not going to change very much. We need to recognize that reality. And the baby boomers are eligible for early retirement beginning in 2008. That is going to start to crunch the budget because the Social Security surpluses are going to start to go down in 2008. That will start putting pressure on the rest of the Federal budget, and ultimately it is only going to get

worse over time. As you know, Medicare is a much bigger problem than Social Security but it is going to take much longer to solve.

Manufacturing, that is an issue. But I think one of the things we have to keep in mind is while obviously one has to look at trade policy, I think the other thing one has to keep in mind is we are truly in a global economy. More and more corporations are multinational corporations. And multinational corporations do not have duties of loyalty to countries. They have duties of loyalty to their shareholders. To the extent that there are other countries that can end up producing things that are not high value and a lot cheaper than us, we are never going to be able to compete on wages.

All the more important that we have to recognize we have to have education systems, retraining systems, and technologies that enable us to compete based on productivity, innovation, quality, those types of factors in order to maintain our standard of living and improve it.

As far as Congress, I would respectfully suggest that there are at least a couple of committees that are of strategic importance. This one, because of the scope of this Committee. You have the authority to deal with all of government operations and look at the effectiveness of government programs. And second, the Budget Committee. Others are very important, do not get me wrong.

But I think those two committees can help lead the way. And I also think this is something that needs visibility in both caucuses because I do not think that many members really understand the true nature, extent, magnitude, and potential implications of this, in part because of how we keep score, as Senator Lieberman mentioned. The way we keep score does not provide a full and fair view of where we are and where we are headed. It does not allow you and your colleagues to make a fully informed decision on really important things. That has got to change.

But I am confident that we can rise to this challenge. I am just concerned about when we are going to get started and I hope today is the beginning of that effort.

Senator COBURN. Let me go back and ask you, based on the history of oversight of the Congresses of the last 10 years, why are you confident that Congress is going to do that?

Mr. WALKER. Because some people are starting to pay attention. When I came into my office this morning, and Madam Chairman, I don't know if you all saw this. I just saw it this morning, and had no idea this was coming out.

Merrill Lynch took out a full-page ad today in the Hill that says GAO to Congress, long-term fiscal policy on unsustainable course. They took that money out of their pocket and their shareholders pocket. I knew nothing about this.

This tells me that Wall Street is watching and that investors and lenders are now starting to get concerned about it. And they should be. And by the way, the dollar has taken a big hit in the last couple of years and that is a shot across the bow. We need to take that seriously.

Senator COBURN. So let me go back. Do you have any ideas, if Congress would decide they want to tackle this, how do we leverage that out so it does not take a generation to do? How do we leverage the ability of this Committee to look both horizontally and ver-

tically and to do assessments and reviews based on some of the outlying characteristics? How do we leverage that to get it done in less than a generation?

Mr. WALKER. First, I think we have to leverage it within the Congress and also elsewhere. For example, the Executive Branch. I would respectfully suggest that since the Executive Branch is the management part of government, and since they have the responsibility for managing the various programs that exist, that they need to look at these generic questions that we have, that apply to every major program, policy, function, and activity. They need to look at the other illustrative questions that we have raised. And they need to start focusing on those, answering those questions. OMB needs to develop a strategic plan and a government-wide performance plan.

In addition to that, I believe that Congress and all of the committees of Congress, should take a look at the contents of this report and consider it as they deem appropriate in setting their agenda for oversight, in considering budget requests that come before the Congress, in considering legislative proposals.

So I think that this is a framework that can and should and must be considered by both the Executive Branch, both career and non-career, as well as the Congress in basically thinking about how it goes about doing its ongoing business on a day-to-day basis. It has to integrate it into the ongoing business operations.

Chairman COLLINS. Thank you. Senator Lautenberg.

Senator LAUTENBERG. Thank you again, Madam Chairman.

Your presentation is excellent and we would expect nothing less, Mr. Walker, knowing you over these years. But I do think that the cart is running ahead of the horse here in terms of how do you solve these problems?

The first thing I would do would extend the terms of U.S. Senators and say maybe you can only serve one 12-year term. And then we would start thinking about the long-range implication of decisions that we make. These are unfortunately tied into political decisions, as you know.

There are some natural factors. When you talk about the implication that some of government record-keeping is a little bit shoddy, is this an Enron we are looking at? Or is it a Fannie Mae or something like that? If you do not have the confidence that you ought to have in what we are producing, then that is a mechanical thing.

I think that we are way beyond that in terms of what the problems are. There is a book around and I commend for my colleagues and general reading. It is called the "End of Work: The Decline of the Global Labor Force and the Dawn of the Post-Market Era." It is written by Jeremy Rifkin. And since I grew up in the technology business in my business career, one of the biggest things that we are looking at is the technological opportunities to replace manual labor. As a consequence, there is an actual shrinkage of the workforce that is taking place in front of us.

One of the things, among several that we have to look at, you cannot have low wages with higher standards of living. And that is axiomatic, in my view. So if we want to go to Bangladesh, or whatever countries, where people live in huts and they will knit

and push machines for 15 cents an hour and want our American workers to compete with that, then we are saying what is going to have to happen is our standard of living is going to have to go down substantially. Because you cannot say to them OK, you live in the huts and you run with the diseases that your kids have, high infant mortality in many cases, and then have us with high wage employees and reasonable standards of living and say that well, we have to match up. Once the marketplace became global, there was enormous change.

I don't mean to give a lecture here but last night Chairman Collins and I saw a film on disaster portrayed in the event of an attack in London using chemicals and radiation. It was a horror. I was forced as I viewed things—and I served in World War II—on a comparative basis the world had a lot fewer casualties for the numbers engaged directly in combat than we see later on.

An observation that I made was that the theater of war, Senator Lieberman, was extended substantially. America itself is now included in the theater of war. That is what happens. Because with technology and madness, any part of our country is susceptible. And therefore, if we have to spend the money necessary to defend ourselves in a theater of war, then the costs are considerable.

It is a lot easier to think of war over there someplace, away from our borders. But we learned on September 11 that we are included. When I was a kid in the Army, in World War II, I saw the first of unmanned missiles. One was a jet bomb, one was a rocket bomb sent by the Germans, unmanned. It was the beginning of a terrible gain in technology. And now that they have been able to compact these weapons, nuclear bombs are small, have them carried by one or two persons willing to conspire, give up their lives to take others. So what is the cost of that?

I submit, without getting too esoteric here, that there is enormous sociological change that we have to examine. The increased longevity, for which I am grateful because otherwise I would not be here, but the fact of the matter is all of these factors come into play. And how we relate the numbers, frankly, is a secondary thing because we want to promote good health and we want to promote not only long life but energy and vitality, as well. And all of these things have enormous costs.

But then what happens to our budgeting?

As you know, Mr. Walker, a financial statement is comprised of two principal parts. One is the revenue side and the other is the expense side. You cannot have a balanced report unless the revenues somehow or other, either through direct production or loans or borrowing, at least equal your expenses. Not indefinitely.

So we are in a peculiar position. I think you did a real service this morning and I thank Senator Collins and Senator Lieberman for promoting this discussion. The question of how you really get to the bare bones is something that we are unwilling to attack with the political events as we see them. Everyone knows that we get closer and closer to encouraging our reelection when the previous one is complete. As a consequence, it is hard to put the longer range things on the table because there is no impact felt right away.

And with that I don't offer you any solutions but I offer more things to be concerned about, I think, and looked at. Thank you.
Chairman COLLINS. Senator Pryor.

OPENING STATEMENT OF SENATOR PRYOR

Senator PRYOR. Thank you, Madam Chairman.

Mr. Walker, again, thank you for your time and attention to this. This is all very important, and of special long-term importance. The work GAO has done on this subject matter has been a very valuable tool for Congress.

Also, you have a great reputation and you have always impressed me as a straight shooter. We need more of that around here, folks that will get through all of the rhetoric and just get down to the facts.

The first question I have is about GAO itself. You have been in operation since the 1920's?

Mr. WALKER. Nineteen hundred and twenty one.

Senator PRYOR. I am curious about GAO's track record in making predictions. Have you ever looked at yourself and tried to go back and see how accurate you have been over the years in making projections?

Mr. WALKER. I have not had that done. We can go back and see whether or not it has been done before and also maybe take a look at what has happened in recent years.

I will tell you this, that having been a trustee of Social Security and Medicare for 5 years, and having been part of the process of projecting out for 75 years for those programs, and knowing that the trustees come up with three estimates, high cost, low cost and best estimate, which we are using for this simulation, in general over the time actual results have been between the best estimate and the high cost estimates.

I know that since I have been Comptroller General, which is a little over 6 years now, that the long-range budget simulations have generally gotten worse over time. The reason that they have generally gotten worse is because we are not necessarily thinking about the long-term cost, affordability and sustainability of current decisions on both the spending side and the tax side of the ledger.

Senator PRYOR. I agree with what you are saying sitting there.

I know that as a Member of the Senate, and just as a Member of Congress generally, I think that we all should continually look at the programs we have for the Federal Government and evaluate them and reevaluate them. I like the areas where you touched on going back to the basics. How long has this program been around? What was the goal of it, etc.? I think that is a very healthy exercise that we should all do.

But I would like to hear your thoughts on a practice that Congress does, and that is we sunset legislation. When we often sunset legislation or we have to reauthorize it at a certain time, is that helping or hurting us in our examination and reform effort to try to make government run more efficiently?

Mr. WALKER. It is a concept that has conceptual merit but quite frankly, many times Congress does not reauthorize programs and yet they are funded. And so that system is not working as anticipated, as well.

I do think that one of the things that has to be done is that there needs to be mechanisms to periodically review and reconsider what is in the base and whether or not Federal programs and policies are achieving their intended objectives and whether or not they are as high a priority today and for tomorrow as it has been in the past.

Senator PRYOR. Do you have a recommendation on that? Are you saying that Congress should be the one that does the reevaluation? Or should Congress somehow get blue ribbon panels or whatever to go and review programs? How should we do that? Do you have a recommendation on that?

Mr. WALKER. One of the things that we have in chapter 3 of this report, or what I would refer to as the way forward, is we have a number of different mechanisms that could potentially be used in order to address these and other questions, some of which need to be embedded in the normal process that Congress deals with, the budget process, the appropriations process, the oversight process, and the reauthorization process.

I do believe, Senator, that it is a shared responsibility. I believe that the Executive Branch should be focusing on these issues, these generic questions as well as the other illustrative questions. I also believe the Congress, as part of its regular legislative, oversight, and appropriations responsibilities, needs to be focused on these issues. So we need both. I do not think we can rely on one or the other. I think both have to play a major role.

Senator PRYOR. So as we are talking about reforming Social Security and at some point reforming Medicare and Medicaid, do you think we need to reform Congress as well?

Mr. WALKER. As you know, the Congress is my client. I will tell you this, I do not believe that either the Executive Branch or the Legislative Branch is well-positioned to deal effectively with all of these challenges that we are facing. Realistically, the Executive Branch is probably going to change before the Congress. But ultimately, I think the Congress is going to have to change in some ways as well to maximize its effectiveness.

Senator PRYOR. One thing that you touched on that Senator Lieberman picked up on is that 60 percent of government spending is on autopilot. Basically, you are talking about the entitlement programs or the mandatory spending categories, whatever we want to call them. Do you have any recommendations on how we address those and how we can make those less expensive and a smaller part of the budget overall?

Mr. WALKER. First in 1964, Congress got to decide how two-thirds of the budget would be spent every year. Now it is down to less than 40 percent and it is getting less each year based upon known demographic trends and a variety of other factors.

We have a number of suggestions in the report but some of the ones that I would touch on would be that we need to start getting some things on the radar screen that are off the radar screen. To a great extent, a lot of this mandatory spending is off the radar screen. We are just letting it go. We are not even focusing on it. That is not just on the spending side, it is on the tax side, too.

As I mentioned, in many years the total cost of tax expenditures exceeds total discretionary spending. And yet, tax expenditures are off the radar screen. We are really not focusing on them.

I think looking at the commitments that have been made, being able to consider triggers, engaging in a fundamental review and reassessment of existing mandatory programs.

I saw this morning, for example, that there is a proposal to extend TriCare to all Reservists and Guard members, even if they are not on active duty. That would cost a tremendous amount of money. Given the fact that employers are looking to get out of the health care business, let me assure you that that would just be an excuse for every member of the Guard and Reserve and their family to go on to the Government TriCare program, which in 1-year cost, or the 10-year cost may not look that bad. But the discounted present value cost would be shocking.

Senator PRYOR. Thank you.

Chairman COLLINS. Thank you.

Mr. Walker, the OMB has put forth a number of proposals to encourage Congress to evaluate Federal programs, and if they are ineffective to terminate them. For example, there already is the OMB Program Assessment Rating Tool, the PART program. Last year, Congress funded all but one of the 13 programs that OMB concluded were either ineffective or had results not demonstrated.

I think the PART program may not be the best tool for evaluating the worthiness of programs, but I think OMB has a point about how difficult it is to terminate programs once they have been enacted.

This year, the administration has proposed a Results Commission and a Sunset Commission to try to put into place some sort of action forcing mechanism to force Congress to make affirmative decisions to extend programs that the commission may have found are ineffective.

What is your general view on the PART program and on the administration's proposals for these two commissions?

Mr. WALKER. I think the PART program, the Program Assessment Rating Tool, has conceptual merit. It is basically the administration's recognition that you need to review the base of government and to try to ascertain whether and to what extent programs are achieving real outcome-based results. And if not, why not? And the ones that are more successful, hopefully, would receive better treatment, at least as it relates to the President's proposal. And the ones that are not demonstrating results, then presumably they would not receive as favorable treatment through the President's proposed budget.

I believe that PART is a step in the right direction. By no means is it perfect. I think you also have to recognize, as you do I'm sure, that any administration is associated with a particular president and a particular party and therefore is not necessarily viewed with the same degree of merit on both sides of the aisle. And that there could be some skepticism, no matter which administration it is, as to what their proposals might be.

And so I think it is important to have GAO and others, as appropriate, doing evaluations that are professional, objective, fact-

based, nonpartisan, nonideological, and hopefully fair and balanced as a supplement to what the administration might do.

I also believe that there needs to be more consultation. I believe the administration has done some good things, but their consultation with key stakeholders has not always been very effective. And working in partnership over a period of time would significantly increase the likelihood of success. Reasonable people can and will differ in these areas. No doubt about it, especially with all the vested interests. But I think there needs to be significant process improvement.

As far as the Results Commission and the Sunset Commission, I have not seen the details. As you know, Senator, titles of things can be misleading. Therefore, I will reserve judgment on what they are proposing until I see the details.

Chairman COLLINS. Let me do just a follow-up, knowing that you would want to get back to us on that issue.

As I understand the administration's proposal for the Sunset Commission, it would review some 1,200 government programs over a 10-year period. So that the concept is that a program's managers would have to justify its continued existence once every 10 years, or at least once every 10 years.

From what you are saying, however, if we take that kind of approach we should look at the other side of the ledger. We should be looking at tax preferences and whether they should be continued. Is that a fair judgment?

Mr. WALKER. Absolutely. I think we have to look at mandatory spending, including entitlement programs, discretionary spending and tax policy, including tax preferences. The gap is too great to grow our way out of the problem. You are not going to solve the problem just by looking at one dimension. We need to look at all three.

Chairman COLLINS. Let me ask you one final question today, and that is in the area of health care. If you look at your charts, the fastest-growing part of the Federal budget is the Medicaid and Medicare programs. It is going to be a tremendous challenge for government to tame the cost.

What should Congress and the administration begin to tackle in what is the fastest-growing part of our budget?

Mr. WALKER. First, one of the things I was pleased to see, although not without controversy, is the President's Budget incorporates a number of GAO recommendations. One example is that there is some gaming going on with regard to Medicaid reimbursements. There has also been some practices that have been engaged in by various other parties where the government, we believe, is paying more than it should and more than was intended. So that is a positive step.

Second, with regard to Medicare, I think some of the things we are going to have to look at is such things as, in the short-term, is there an opportunity to be able to develop some standards of practice that would improve quality, reduce costs, enhance consistency, improve equity, also potentially reduce litigation risk?

Third, is there an opportunity to engage in large case management practices? A significant percentage of Medicare's cost, and Medicaid's too, are incurred by a relatively small percentage of the

covered population. In the private sector and even some State and local governments, there are large case management practices that are being engaged in to try to get a better handle as to what people are doing and what the costs are. Sometimes you find yourself, you have people taking 16 prescription drugs, which is dangerous, or they are working counter to each other. That is another example.

A fourth one might be how can you leverage the government's considerable purchasing power?

But in the final analysis, Senator, Medicare by itself is eight times greater than Social Security. Medicaid is on top of that. It is going to take fundamental reform on an installment basis over many years, not just of these programs but also the entire health care system.

And that is why I think it is important that the Congress consider moving now rather than later on Social Security reform. The reason being is that while Social Security is only \$3.7 trillion of that \$43 trillion problem, you have an opportunity to reform Social Security in a way that will exceed the expectations of every generation of Americans—and I will be happy to comment on that if you want. You can get a win and improve credibility in the markets, improve confidence within the public and within the Congress to be able to deal with issues before they reach crisis proportions because quite frankly the heavy lifting is going to take a lot more time and you are not going to exceed the expectations of any generation of Americans, I would respectfully suggest.

Chairman COLLINS. Thank you. Senator Lieberman.

Senator LIEBERMAN. Thanks, Madam Chairman.

Mr. Walker, earlier on in your testimony you mentioned a series of steps that Congress could take to try to get us back in balance. And look, we are proving, unfortunately, that we are incapable of just doing it in the normal process, that we have got to create some parameters here, some fences around the holes we are falling into. I am going to list the ones: Spending caps, PAYGO rules, triggers, and biannual budgeting. One of our colleagues has a Constitutional Amendment on a line item veto, which we passed some years ago and then was struck down by the Supreme Court. So this is his attempt to try to bring it back.

Of those, and this Committee—and I appreciate the Chairman's leadership in calling this hearing and beginning the process—this Committee is in a position to try to take the lead in offering some legislative parameters to self-discipline. What would be your favorite among those, or a couple of favorites, and just talk about the details of why you chose them?

Mr. WALKER. We would be happy to work with your staff and other Committee staff further, but on a preliminary basis what I would say is some spending caps and PAYGO on both sides of the ledger. In addition, to consider, as a supplement to and not a substitute for, the current information Congress gets, the discounted present value dollar cost of major tax and spending proposals before they are enacted into law.

There are others but those would be a few off the top of my head. Senator LIEBERMAN. That is helpful.

Can I take you back and ask you just to talk a little bit, and I would welcome your input or your staff's, on spending caps? Just describe in general terms how we might best do that?

Mr. WALKER. Realistically, I think there are probably a couple of different approaches. One is you may want to take a look at what type of target or cap you might have, not just with regard to discretionary spending. But I also think that you have to think about whether or not you have certain triggers or mechanisms that deal with mandatory spending, where you are on autopilot, that forces some type of review and reconsideration, rather than just automatically assuming we are going to continue the status quo.

I think you also have to think, and I am talking off the top of my head here, Senator, a little bit, brainstorming with you. I think we have to think about what are we going to do on the tax preference side. That cannot be off the radar screen, either.

For example, one of the things that I noted in the President's budget is there is a proposal for additional tax preferences for health care. It is already the largest tax preference in the Internal Revenue code. And yet we are proposing additional ones. What about reconsidering the existing one?

So I think that somehow we have to consider the tax side too, because in the final analysis we are talking about the bottom line. And the bottom line is a function of revenues and expenditures. And therefore you need to consider both.

Senator LIEBERMAN. How about PAYGO. PAYGO is the basic idea, as the name suggests, that if you adopt a spending program or a tax cut you have to pay for it.

Mr. WALKER. I think it needs to apply on both sides of the ledger because we are talking about the bottom line.

Senator LIEBERMAN. What are your thoughts about a line item veto, leaving aside whether it is significant enough to amend the Constitution?

Mr. WALKER. That would involve a significant change in authority between the Legislative Branch and the Congress, who I and GAO work for, and the Executive Branch. So I hesitate to say more on that at this time, Senator.

Senator LIEBERMAN. That was well done. But let us continue to work on that.

Let me ask you a very different kind of question, although related to the general subject, and bring you to where Congress is focused today, which is on trying to make Social Security sustainable. One of the things that bothers me about the current proposal, insofar as we understand it, for privatizing accounts, and I am really trying hard, as a lot of members are, to keep our minds open. As I said at the outset, the President has forced us to confront the long-term unsustainability of Social Security. So one or another may argue about what his response is, but he put it on the agenda.

One of the questions that I have asked myself is on the privatizing, which requires transition costs and borrowing to achieve them—and that goes into the trillions, as Vice President Cheney said a few weeks ago, over the decades to come. How do we measure whether that indebtedness really begins to affect our international financial credibility to the point where the dollar

loses value, interest rates have to be raised, business is stifled, people lose jobs?

What standards can we apply to that? I guess I will stop there and I may have a quick follow-up.

Mr. WALKER. Senator, I would guess, one of the things we have to be careful about in the debate about Social Security is the words that we use. I would respectfully suggest that just as a crisis may not be an appropriate word, privatizing may not be either. Because in effect, what is being talked about with individual accounts is whether or not there should be individual accounts. If so, as part of a broader proposal. Because by themselves they will not deal with the solvency and sustainability problem. In fact they could exacerbate it.

Senator LIEBERMAN. That is a real important point. There may be a value to those private accounts for a lot of other personal and macroeconomic reasons, but they themselves do not deal with the system.

Mr. WALKER. That is exactly right, Senator. The question is are they a carve-out? In other words, are they part of the existing payroll tax? Are they an add-on? Are they voluntary? Are they mandatory?

I will say this, we need to consider, I believe, in any reform proposals not just the cash flow implication but also the discounted present value dollar implication of whatever reform package is being considered. We are consistent at GAO. We say we think you need to consider both, on the tax side, on the spending side, as well as part of major reform proposals.

I think the other thing that we have to consider is that not all promised benefits under Social Security are funded. If you want to deliver on all promised benefits under Social Security, it is going to cost several trillion dollars to be able to do that at some point in time. The question is when?

So one last thing I would mention on this is if you look at the financial statements of the U.S. Government, you will not find a liability to the trust funds of Social Security and Medicare, shockingly. The reason that you will not find a liability is because the left hand owes the right hand. That is something I think that needs to be reconsidered. Why? Because after the government took the people's payroll taxes, it spent the people's payroll taxes, and it put an IOU in the so-called "trust funds."

Senator LIEBERMAN. Which we are going to have to start paying.

Mr. WALKER. Correct. You are going to have to start paying. The IOU's are guaranteed as to principal and interest. The bonds are backed by the full faith and credit of the U.S. Government. That has legal, political, and moral significance, but no economic significance whatsoever. Social Security is going to start to constrain the budget in 2008, as the surplus starts to go down. It is going to get worse over time.

At the same time, when you go from implicit debt, which is the unfunded gap, to explicit debt——

Senator LIEBERMAN. Which we will have to deal with, either by cutting current government spending or raising more revenue.

Mr. WALKER. Correct. Or you can go out to the market to borrow it. You either have to raise revenues, cut expenses or increase debt held by the public.

If you do that, then you are competing with other capital needs. The question is what interest rates are you going to have to pay? Part of the issue is how much credibility does the reform package have in the market because, on the one hand, it is good news if Congress is able to handle a known problem before it absolutely has to, which is what it did in 1983. In 1983, the checks were not going to go out on time! So the market would presumably give you some credit for handling a known problem before an absolute crisis was on your doorstep.

On the other hand, you are going to be competing for capital and it is to be determined what impact that might have on interest rates.

Senator LIEBERMAN. Thank you. Thanks very much. It has been a very important morning.

Chairman COLLINS. Thank you very much, Senator Lieberman, for your participation in this important hearing.

Mr. Walker, thank you so much for the great work that GAO is doing in this area.

Mr. Walker, I think this is extraordinarily important work, as your first comments implied to us. We look forward to continuing this process with you, in helping us identify more precisely where we should begin focusing and tackling some of these issues.

And also, on the possible budget reforms, which I really think could be key in getting control and imposing fiscal discipline.

The hearing record will be held open for 15 days for the submission of questions and additional materials.

I again want to thank you and your staff, and I want to thank our Committee staff for their hard work.

This Committee is now adjourned.

[Whereupon, at 11:42 a.m., the Committee was adjourned.]

A P P E N D I X

GAO

United States Government Accountability Office

Testimony

Before the Senate Committee on Homeland Security and
Governmental Affairs

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21st CENTURY CHALLENGES

Reexamining the Base of the Federal Government

Statement of David M. Walker
Comptroller General of the United States



GAO-05-352T

Chairman Collins, Senator Lieberman and Members of the Committee:

Thank you for the opportunity to present and discuss the report we are issuing today entitled *21st Century Challenges: Reexamining the Base of the Federal Government*. We appreciate the interest and support of this committee and others of GAO's efforts to produce this report for the Congress. This report stems from the recognition that the Congress faces a daunting challenge: the need to bring government and its programs in line with 21st century realities. This challenge has many related pieces: addressing our nation's large and growing long-term fiscal gap; deciding on the appropriate role and size of the federal government—and how to finance that government—and bringing the panoply of federal activities into line with today's world. We believe that GAO has an obligation to assist and support the Congress in this effort. The reexamination questions discussed in today's report are offered in that spirit: they are drawn primarily from the work GAO has done for the Congress over the years. We have attempted to structure questions that we hope you will find useful as the Congress determines which issues it plans to examine and act on. Many of the questions in this report do not represent immediate crises, however many pose important longer term threats to our country's fiscal and economic, and national security as well as the quality of life for our children and grandchildren.

As I have said before, our nation is on an unsustainable fiscal path. Long-term budget simulations by GAO, the Congressional Budget Office (CBO), and others show that, over the long term we face a large and growing structural deficit due primarily to known demographic trends and rising health care costs. Continuing on this unsustainable fiscal path will gradually erode, if not suddenly damage, our economy, our standard of living, and ultimately our national security. All reasonable simulations indicate that the problem is too big to be solved by economic growth alone or by making modest changes to existing spending and tax policies. Rather, a fundamental reexamination of major spending and tax policies and priorities will be important to recapture our fiscal flexibility and ensure that our programs and priorities respond to emerging social, economic, and security changes and challenges.

Ultimately, this reexamination will entail a national discussion about what Americans want from their government and how much they are willing to pay for those things. It will also involve how the government should conduct its business for the 21st century. Many, if not most, current federal programs and policies were designed decades ago to respond to trends and

challenges that existed at the time of their creation. Our recent entry into a new century has helped to remind us of how much has changed in the past several decades—whether it be rapid shifts in the aging of our population, the globalization of economic transactions, the significant advances in technology, and changing security threats. If government is to effectively address these trends, it cannot accept its existing programs, policies and activities as “givens.” Outmoded commitments and operations can constitute an encumbrance on the present and future that can erode the capacity of the nation to better align its government with the needs and demands of a changing world and society.

Rethinking the base of existing federal spending and tax programs is an important step in this process. A periodic reexamination offers the prospect of addressing emerging needs by weeding out programs and policies that are outdated and ineffective. Those programs that remain relevant can be updated and modernized by improving their targeting and efficiency through such actions as redesigning allocation and cost sharing provisions, consolidating facilities and programs and streamlining and reengineering operations and processes. The tax policies and programs financing the federal budget can also be reviewed with an eye toward the overall level of revenues that are necessary to fund government operations and commitments, the mix of taxes that should be used, and the extent to which the tax code is used to promote certain societal objectives.

In my testimony today I will try to provide a context for, and a guide to, this report. First, I will talk about why and how we developed this report. Next, I will touch on the long-term fiscal challenge, which provides the primary impetus for this overall reexamination effort. The bulk of my statement deals with five of the fundamental trends that are shaping the world and the federal role in our economy and our society: demographics, global interdependence, economic change, evolving security threats and governance challenges. In this discussion I’ll talk about how the issues discussed in this report can be used to assist you in your policy making and oversight activities.

Reexamining the Base of the Federal Government

Let me start by telling you a little more about the genesis of this report. GAO has long had a statutory responsibility for monitoring the nation’s finances. Recently, in our role as the auditor of the U.S. government’s consolidated financial statements, we included an emphasis paragraph in the audit report for fiscal year 2004 expressing our concerns about the unsustainability of the nation’s long-term fiscal outlook. This conclusion

was based on the results of fiscal year 2004 and GAO's long-term budget model, which we have used since 1992.

Moreover, as you know, in our role as the audit, evaluation, and investigative arm of the Congress, we have provided our perspectives on a wide range of key performance and accountability challenges facing the federal government, both in numerous reports and testimonies over the years and compendiums such as our high-risk reports. We have also looked forward by developing a strategic plan, consistent with the Government Performance and Results Act (GPRA) and in consultation with the Congress, identifying the emerging forces and trends that are impairing the United States, its citizens and its position in the world.

Given these trends and challenges facing the nation, we believe that GAO now has an obligation to provide policymakers with the benefit of our institutional knowledge to identify selected areas throughout government that could be considered for reexamination and review. Drawing on our past and pending work—about 90 percent of which is either requested by the Congress or required by law—we have provided examples of the kinds of hard choices stemming from these challenges in the form of questions for elected officials and other policy makers to consider. These 21st century questions cover discretionary spending, mandatory spending including entitlements, as well as tax policies and programs.

The specific 21st century questions were based, in part, on GAO's strategic plan for serving the Congress,¹ which identified major trends that will shape the federal role in the future. (See table 1.)

Table 1: Strategic Plan Themes

• Long-Range Fiscal Challenges	• Demographic Shifts
• Changing Security Threats	• Science and Technology Advances
• Increasing Global Interdependence	• Quality of Life Trends
• The Changing Economy	• Changing Governance Structures

Source: GAO.

¹ GAO, *Strategic Plan for Serving the Congress and the Nation, 2004-2009* (Washington, D.C.: March 2004).

These trends, along with GAO's institutional knowledge and issued work, helped us identify the major challenges and specific questions. The specific questions were informed by a set of generic evaluation criteria which are useful for reviewing any government program or activity; these are displayed in table 2.

Table 2: Illustrative Generic Reexamination Criteria

Relevance of purpose and the federal role	<p>Does it relate to an issue of nationwide interest? If so, is a federal role warranted based on the likely failure of private markets or state and local governments to address the underlying problem or concern? Does it encourage or discourage these other sectors from investing their own resources to address the problem?</p> <p>Have there been significant changes in the country or the world that relate to the reason for initiating it?</p> <p>If the answer to the last question is "yes," should the activity be changed or terminated, and if so, how? If the answer is unclear as to whether changes make it no longer necessary, then ask, when, if ever, will there no longer be a need for a federal role? In addition, ask, would we enact it the same way if we were starting over today? Has it been subject to comprehensive review, reassessment, and re-prioritization by a qualified and independent entity? If so, when? Have there been significant changes since then? If so, is another review called for?</p> <p>Is the current mission fully consistent with the initial or updated statutory mission (e.g., no significant mission creep or morphing)? Is the program, policy, function, or activity a direct result of specific legislation?</p>
Measuring success	<p>How does it measure success? Are the measures reasonable and consistent with the applicable statutory purpose? Are the measures outcome-based, and are all applicable costs and benefits being considered? If not, what is being done to do so?</p> <p>If there are outcome-based measures, how successful is it based on these measures?</p>
Targeting benefits	<p>Is it well targeted to those with the greatest needs and the least capacity to meet those needs?</p>
Affordability and cost effectiveness	<p>Is it affordable and financially sustainable over the longer term, given known cost trends, risks, and future fiscal imbalances?</p> <p>Is it using the most cost-effective or net beneficial approaches when compared to other tools and program designs?</p> <p>What would be the likely consequences of eliminating the program, policy, function, or activity? What would be the likely implications if its total funding was cut by 25 percent?</p>

(Continued From Previous Page)

Best practices If it fares well after considering all of these questions, is the responsible entity employing prevailing best practices to discharge its responsibilities and achieve its mission (e.g., strategic planning, organizational alignment, human capital strategy, financial management, technology management, acquisitions/sourcing strategy, change management, knowledge management, client/customer service, risk management)?

Source: GAO.

In the report, we describe the forces at work, the challenges they present, and the 21st century questions they prompt, in each of 12 broad areas based in large measure on functional areas in the federal budget, but also including governmentwide issues and the revenue side of the budget as listed in table 3.

Table 3: Twelve Reexamination Areas

Mission Areas	
Defense	Natural Resources, Energy & Environment
Education & Employment	Retirement & Disability
Financial Regulation & Housing	Science & Technology
Health Care	Transportation
Homeland Security	
International Affairs	
Crosscutting Areas	
Governance	Tax System

Source: GAO.

Our report contains over 200 individual illustrative questions in these 12 areas. In the remainder of my statement I will discuss some of the questions in the context of the major strategic challenges facing the nation.

Long-term Fiscal Challenge Provides Reexamination Impetus

Chairman Collins, the nation is facing a range of important new forces that are already working to reshape American society, our place in the world and the role of the federal government. Our capacity to address these and other emerging needs and challenges will be predicated on when and how we deal with our fiscal challenges—the long-term fiscal pressures we face are daunting and unprecedented in the nation's history. The size and trend of our projected longer term deficits means that the nation cannot ignore the resulting fiscal pressures—it is not a matter of whether the nation deals with the fiscal gap, but when and how. Unless we take effective and timely

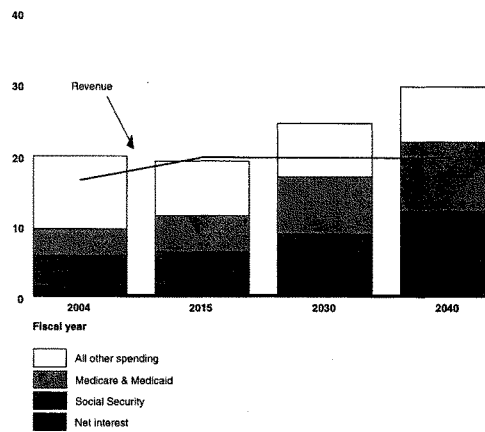
action, our near-term and longer-term deficits present the prospect of chronic and seemingly perpetual budget shortfalls and constraints becoming a fact of life for years to come. Not only would continuing deficits eat away at the capacity of everything the government does, but they will erode our ability to address the wide range of emerging needs and demands competing for a share of a shrinking budget pie.

GAO's long-term simulations illustrate the magnitude of the fiscal challenges we will face in the future. Figures 1 and 2 present these simulations under two different sets of assumptions. In the first, simulation is based on the CBO January baseline—constructed according to the statutory requirements for that baseline.² Consistent with these requirements, this simulation assumes no changes in current law, that discretionary spending is assumed to grow with inflation for the first 10 years, and that tax cuts which are currently scheduled to expire will expire. After 2015, discretionary spending is assumed to grow with the economy, and revenue is held constant as a share of GDP at the 2015 level. In the second figure, only two assumptions are changed: (1) discretionary spending is assumed to grow with the economy rather than merely with inflation for the entire period (not just after 2015), and (2) all tax cuts which are currently scheduled to expire are made permanent. For both simulations Social Security and Medicare spending is based on the 2004 trustees' intermediate projections, and we assume that benefits continue to be paid in full after the trust funds are exhausted. Medicaid spending is based on CBO's December 2003 long-term projections under mid-range assumptions.

² The Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2006 to 2015* (Washington, D.C.: January 2005).

Figure 1: Composition of Spending as a Share of Gross Domestic Product (GDP) Under Baseline Extended

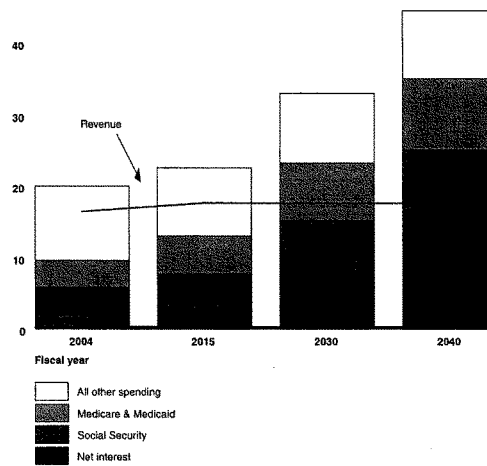
50 Percent of GDP



Source: GAO's January 2005 analysis.

Notes: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2015 due to (1) real bracket creep, (2) more taxpayers becoming subject to the alternative minimum tax (AMT), and (3) increased revenue from tax-deferred retirement accounts. After 2015, revenue as a share of GDP is held constant.

**Figure 2: Composition of Spending as a Share of Gross Domestic Product
Assuming Discretionary Spending Grows with GDP after 2005 and All Expiring Tax
Provisions Are Extended**
50 Percent of GDP



Source: GAO's January 2005 analysis.

Notes: Although expiring tax provisions are extended, revenue as a share of GDP increases through 2015 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2015, revenue as a share of GDP is held constant.

As both these simulations illustrate, absent policy changes on the spending and/or revenue side of the budget, the growth in spending on federal retirement and health entitlements will encumber an escalating share of the government's resources. Indeed, when we assume that recent tax reductions are made permanent and discretionary spending keeps pace with the economy, our long-term simulations suggest that by 2040 federal revenues may be adequate to pay little more than interest on the federal

debt. Neither slowing the growth in discretionary spending nor allowing the tax provisions to expire—nor both together—would eliminate the imbalance. Although revenues will likely be part of the debate about our fiscal future, making no changes to Social Security, Medicare, Medicaid, and other drivers of the long-term fiscal gap would require at least a doubling of taxes in the future—and that seems both inappropriate and implausible. Accordingly, substantive reform of Social Security, Medicare and other major mandatory programs remains critical to recapturing our future fiscal flexibility.

The government can help ease our nation's future fiscal burdens through actions on the spending and/or revenue side that reduce debt held by the public, increase saving for the future, and enhance the pool of economic resources available for private investment and long-term growth. Economic growth is essential, but we will not be able to simply grow our way out of the problem. The numbers speak loudly: Our projected fiscal gap is simply too great. Closing the current long-term fiscal gap would require sustained economic growth far beyond that experienced in U.S. economic history since World War II. Tough choices are inevitable, and the sooner we act the better.

Fundamental Forces Will Test Existing Policy Frameworks

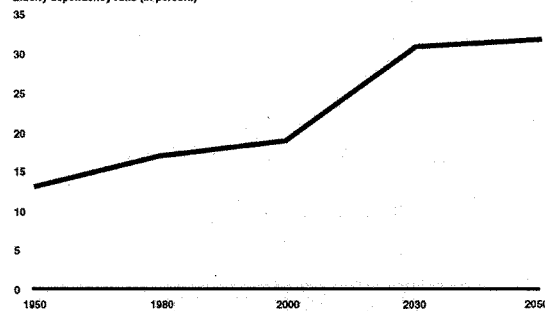
Fiscal necessity can become the mother of invention and of much needed reforms in government programs and activities. The nation's continued economic progress, social well being and national security in the 21st century will in large part depend on how we adapt and respond to these rapid changes and growing fiscal challenges.

We hope the reexamination questions presented in our report today can facilitate a fundamental overview and reexamination of the base of government programs, policies and activities. As I noted earlier, in organizing these questions we started with major trends that are shaping the world and the federal role in our economy and our society. I'd like to spend some time today discussing five of the trends we have identified in our strategic plan for serving the Congress and how they prompt the need to consider the base of government across several of the 12 areas addressed in the report. I'll start with demographics, including the aging of our population, and then discuss increasing global interdependence, economic change, evolving security threats and changing governance systems.

An Aging Population

As the baby boomers age, people will live longer and spend more time in retirement. As shown in figure 3, the U.S. elderly dependency ratio is expected to continue to increase.³ The proportion of the elderly population relative to the working-age population in the U.S. rose from 13 percent in 1950 to 19 percent in 2000. By 2050, there is projected to be almost one elderly dependent for every three people of working age⁴—a ratio of 32 percent. Additionally, the average life expectancy of males at birth has increased from 66.6 in 1960 to 74.3 in 2000, with females at birth experiencing a rise from 73.1 to 79.7 over the same period. As general life expectancy has increased in the United States, there has also been an increase in the number of years spent in retirement.

Figure 3: U.S. Elderly Dependency Ratio Expected to Continue to Increase
Elderly dependency ratio (in percent)



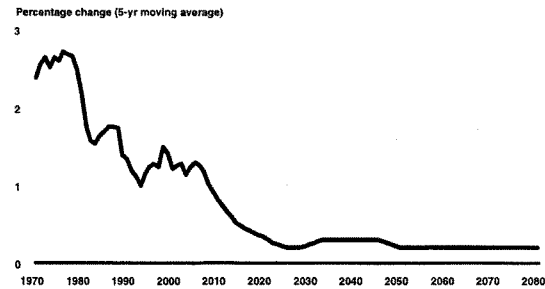
Source: Population division of the Department of Economic and Social Affairs of the United Nations Secretariat, World Population Prospects: 2002 Revision and World Urbanization Prospects: 2001 Revision. Data for 2030–2050 are projected.

³ The elderly dependency ratio is the ratio of the population aged 65 years or over to the population aged 15 to 64.

⁴ For the Social Security system—which does not cover the entire U.S. population—the ratio of beneficiaries to workers is estimated to be 1 to 2 at that time.

A falling fertility rate is the other principal factor underlying the growth in the elderly share of the population. In the 1960s, the fertility rate was an average of three children per woman. Today it is a little over two, and by 2030 it is expected to fall to 1.95. The combination of these factors means that annual labor force growth will begin to slow after 2010 and by 2025 is expected to be less than a fifth of what it is today. (See fig. 4.) Thus, relatively fewer workers will be available to produce the goods and services that all will consume. Lower labor force growth will lead to slower growth in the economy and to slower growth of federal revenues.

Figure 4: Labor Force Growth Is Expected to Slow Significantly



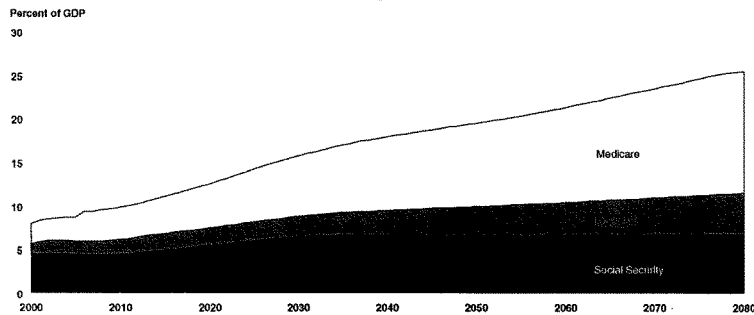
Source: GAO analysis of data from the Office of the Chief Actuary, Social Security Administration.

Note: Percentage change is calculated as a centered 5-year moving average of projections based on the intermediate assumptions of the 2004 Trustees' Reports.

As noted earlier, these trends have major implications for federal budget policy and will prompt a reexamination of national retirement programs, health care and workforce policies. Although considerable uncertainty surrounds long-term budget projections, we know two things for certain: the population is aging and the baby boom generation is approaching retirement age. The aging population and rising health care spending will have significant implications not only for the budget, but also for the economy as a whole. Figure 5 shows the total future draw on the economy represented by Social Security, Medicare, and Medicaid. Under the 2004 Trustees' intermediate estimates and CBO's long-term Medicaid estimates, spending for these entitlement programs combined will grow to 15.6

percent of GDP in 2030 from today's 8.5 percent. It is clear that, taken together, Social Security, Medicare, and Medicaid represent an unsustainable burden on future generations.

Figure 5: Social Security, Medicare, and Medicaid Spending as a Percent of GDP



Source: GAO analysis based on data from the Office of the Chief Actuary, Social Security Administration, Office of the Actuary, Centers for Medicare and Medicaid Services, and the Congressional Budget Office.

Note: Social Security and Medicare projections based on the intermediate assumptions of the 2004 Trustees' Reports. Medicaid projections based on CBO's January 2005 short-term Medicaid estimates and CBO's December 2003 long-term Medicaid projections under mid-range assumptions.

These trends portend major changes in our current national social insurance system. A core element of the system was a certain and secure retirement income component—with Social Security as a foundation. Social Security is intended to be supplemented by a private pension system and individual savings arrangements—which, in combination, sought to conquer the long-standing economic fear of poverty in old age. Effectively responding to the long-term and structural challenges discussed above will entail fundamental and comprehensive reassessment of each of the key components of our retirement and disability system.

Social Security could be brought into balance over the next 75 years in various ways. If reforms were to be instituted today, an immediate increase in payroll taxes of 15 percent or an immediate reduction in currently promised benefits of 13 percent, or some combination of the two would be

required to bring the program into balance. Waiting to reform the system will require even greater changes as time passes. Encouraging older workers to extend their labor force participation can also improve the solvency and sustainability of the program while enhancing overall economic growth.

Weaknesses in the nation's private pension system have also become evident. Traditional defined benefit plans where employers rather than employees bear the risk of investment have been shrinking for decades, and recent terminations of plans have threatened the solvency of the Pension Benefit Guaranty Corporation (PBGC). Policymakers will need to consider how to best encourage wider pension coverage and enhance pension security. They will also need to consider how the private pension system and any related reforms will interact with prospective changes in Social Security.

Meanwhile, federal disability programs, such as those at the Social Security Administration (SSA) and the Department of Veterans Affairs (VA), are challenged by significant growth over the past decade that is expected to surge even more as increasing numbers of baby boomers reach their disability-prone years. Federal disability programs remain mired in concepts from the past and are poorly positioned to provide meaningful and timely support for workers with disabilities. Advances in medicine and science have redefined what constitutes an impairment to work, and the nature of work itself has shifted toward service and knowledge-based employment—these developments need to be reflected in agencies' eligibility and review processes.

Although Social Security is currently the largest program in the federal budget, it will soon be eclipsed by Medicare and Medicaid, which are fast growing programs in the federal budget both now and over the longer term. Many policymakers, industry experts, and medical practitioners contend that the U.S. health care system—in both the public and private sectors—is in crisis. Long-term health spending growth in Medicare and Medicaid is driven by both the aging of the population and the rapid growth of health care costs. In the private sector, employers and other private purchasers of health care services find that the soaring cost of health insurance premiums poses a threat to their competitive position in an increasingly global market.

Despite the significant share of the economy consumed by health care, a number of key U.S. health outcomes continue to lag behind other

industrialized nations. The United States now spends over 15 percent of its gross domestic product on health care—far more than other major industrialized nations. Yet relative to these nations, the United States performs below par in such measures as rates of infant mortality, life expectancy, and premature and preventable deaths. Moreover, evidence suggests that the American people are not getting the best value for their health care dollars. Studies show that quality is uneven across the nation, with a large share of patients not receiving clinically proven, effective treatments. At the same time, access to basic health care coverage remains an elusive goal for nearly 45 million Americans without insurance, with a growing percentage of workers losing their employer-based coverage. Many more millions of Americans are underinsured or have lost some of the benefits their health plans previously afforded.

The policy process will be challenged to fundamentally rethink the design of our health care system. Defining differences between wants, needs, affordability, and sustainability will be fundamental to rethinking the design of our current health care system. Among the areas that should be on the table is how to balance responsibility for financing health care among government at all levels, employers and individuals. In the past several decades, the responsibility for financing health care at the point of delivery has shifted away from the individual patient, falling from nearly half—46 percent—of health care spending 40 years ago to 14 percent today. Tax preferences for insured individuals and their employers have also shifted some of the financial burden for private health care to all taxpayers. Tax policies permit the value of employees' health insurance premiums to be excluded from the calculation of their taxable earnings and exclude the value of the premium from the employers' calculation of payroll taxes for both themselves and employees. These tax exclusions represent a significant source of forgone federal revenue and work at cross-purposes to the goal of moderating health care spending. Health savings accounts and other consumer-directed plans, which shift more of health financing to the individual, also have been accorded various tax preferences.

Promoting consistent quality of care is another challenge facing the health care system. Public and private payers are experimenting with payment reforms designed to foster the delivery of care that is clinically proven to be effective. Ideally, identifying and rewarding efficient providers and encouraging inefficient providers to emulate best practices will result in better value for the dollars spent on care. However, implementing performance-based payment reforms, among other strategies, on a systemwide basis, will depend on system components that are not

currently in place nationwide—such as compatible information systems to facilitate the production and dissemination of medical outcome data, safeguards to insure the privacy of electronic medical records, improved transparency through increased measurement and reporting efforts, and incentives to encourage adoption of evidence-based practices. These same system components would be required to develop medical practice standards, which could serve as the underpinning for effective medical malpractice reform while reducing costs and improving quality of care. Policymakers would need to consider the extent to which federal leadership could foster these system components.

As the foregoing suggests, the aging population will have profound implications for our policies and programs. The following kinds of questions illustrate the kinds of choices we face:

- **Social Security**—How should Social Security be reformed to provide for long-term program solvency and sustainability while also ensuring adequate benefits (for example, increase the retirement age, restructure benefits, increase taxes, and/or create individual accounts)?
- **Labor Force**—How can existing policies and programs be reformed to encourage older workers to work longer and to facilitate phased retirement approaches to employment (for example, more flexible work schedules or receiving partial pensions while continuing to work)?
- **Private Pensions**—What changes should be made to enhance the retirement income security of workers while protecting the fiscal integrity of the PBGC insurance program (for example, increasing transparency in connection with underfunded plans, strengthening pension funding rules, modifying PBGC's premium structure and insurance guarantees, or restricting benefit increases and the distribution of lump sum benefits in connection with certain underfunded plans)?
- **Disability programs**—How can federal disability programs, and their eligibility criteria, be brought into line with the current state of science, medicine, technology, and labor market conditions?
- **Health care reform**—How can we perform a systematic reexamination of our current health care system? For example, could public and private entities work jointly to establish formal reexamination processes that would (1) define and update as needed a minimum core

of essential health care services, (2) ensure that all Americans have access to the defined minimum core services, (3) allocate responsibility for financing these services among such entities as government, employers, and individuals, and (4) provide the opportunity for individuals to obtain additional services at their discretion and cost?

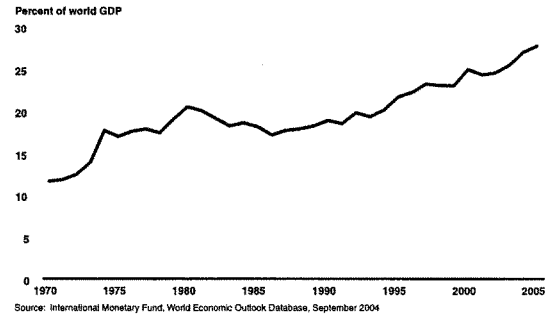
- **Health care financing**—How can health care tax incentives be designed to encourage employers and employees to better control health care costs? For example, should tax preferences for health care be designed to cap the health insurance premium amount that can be excluded from an individual's taxable income?
- **Health care quality**—How can industry standards for acceptable care be established and payment reforms be designed to bring about reductions in unwarranted medical practice variation? For example, what can or should the federal government do to promote uniform standards of practice for selected procedures and illnesses?

Increasing Global Interdependence

The rapid increase in the movement of economic and financial goods, people, and information around the world demonstrates that the nation is no longer self-contained, either in its problems or their solutions. The growing interdependence of nations—globalization—has brought clear economic and social benefits. But while the world has “gotten smaller,” it has raised new challenges for policymakers that require the nation to be involved in or respond to events outside its borders.

One measure of growing worldwide interdependence is the total share of world goods and services that is traded. As shown in figure 6, from 1970 through 2005, world exports increased from about 12 percent to about 28 percent of world GDP. Hence, all over the world, people are depending more and more on other nations to consume the goods they produce and to produce the goods they in turn consume.

Figure 6: World Exports of Goods and Services as a Share of World GDP, 1970–2004



In addition, the internationalization and liberalization of financial markets worldwide, along with growing wealth in many countries, have fueled huge increases in cross-border investments. Information is also moving across borders, as indicated by the rapid adoption of the use of the Internet—from 1991 through 2001 the number of Internet users increased from 4.4 million to 502 million.

Increased global interdependency and rapid technological advancement in the financial services industry pose significant challenges to U.S. regulatory institutions. The present federal financial regulatory structure evolved largely as a result of periodic ad hoc responses to crises such as financial panics. Thus the current regulatory structure includes numerous regulators that specialize in areas such as banking, securities, futures, and insurance but that have difficulty seeing the total risk across industry lines of the entities they regulate. In the last few decades, however, the financial services industry, especially as represented by the largest firms, has evolved, becoming more global, more concentrated, complex, and consolidated across sectors, and increasingly converging in terms of product offerings. Consumers are faced with an increasingly complicated array of options for managing their personal finances and selecting investments and credit products. Individuals can also invest in companies worldwide and can be defrauded or have their identities stolen from almost anywhere.

The shift to a global economy is challenging customary federal approaches to education and employment. The global economy, advances in technology, and the availability of foreign workers, enable work to be shifted to other countries or render some U.S. jobs obsolete. If we are to compete effectively, our educational system must provide the means for adults to continue to learn new skills and enhance their existing abilities and competitive posture. As an increasingly volatile job market creates and eliminates jobs, federal programs that train new workers or support workers who lose their jobs must also be capable of responding to sudden changes in the economy. It will also be important to consider whether the number of visas allowed for both employment and education may affect long-term competitiveness, and our ability to build bridges with other nations, their people, and their cultures while also addressing our national and homeland security needs.

Global and shifting trade patterns create a range of challenges for policymakers. The high level of U.S. trade deficits, rapid increases in imports from nations such as China, and the increase in services trade have led to questions about the best way to ensure that trade is fair and contributes to the well-being of Americans. The globalization of economic activity is bringing an increasing share of the U.S. economy under the domain of international agreements. Economic activity historically viewed as isolated from international trade agreements, such as local government procurement practices, may come under the scrutiny of other parties to the trade agreements, and increasingly be subject to their enforcement machinery.

The U.S. position in the worldwide economy has fundamentally changed, and increasing globalization and the shifting of business income overseas prompts questions about the administrability and sustainability of our current income-based tax system. Furthermore, the Internal Revenue Service faces significant tax enforcement challenges. The tax gap—the difference between what taxpayers annually report and pay and what they should have reported and paid in taxes—was estimated at over \$300 billion in 2001, and IRS has been challenged in recent years to assess and collect taxes stemming from increasingly complex international business activity and transactions. The ongoing debate over tax system reform is partly about whether the tax revenues needed to fund the federal government can best be raised using the current structure, which is heavily dependent on income taxes, or a fundamentally different structure, which might include more dependence on consumption taxes. As policymakers grapple with such issues, they will have to balance multiple objectives such as economic

growth, equity, effectiveness, simplicity, transparency, fairness, and administrability while raising the needed revenue.

As the foregoing suggests, globalization will have profound implications for our policies and programs. The following kinds of questions illustrate the kinds of choices we face:

- **Financial regulation**—Is it time to modernize our financial regulatory system by consolidating various federal regulatory agencies to promote a more coherent and integrated structure while specifying federal goals more clearly?
- **Financial literacy**—What role should the federal government take in improving financial literacy among consumers, and what are the most effective strategies for doing so?
- **Workforce retraining**—Do current workforce retraining programs provide adequate incentives to help the United States develop lifelong learning strategies and proactive training programs? Should current federally funded training programs operated across multiple federal agencies—9 federal agencies administer 44 such programs—be better integrated and restructured to increase their cost effectiveness?
- **Domestic subsidies**—Do current federal agricultural policies and programs, which largely rely on subsidies, contribute to unfair trade? In addition, do current policies remain relevant to the modern agricultural sector?
- **Tax enforcement**—How can we best strengthen enforcement of tax laws to give taxpayers confidence that their friends, neighbors, and business competitors are paying their fair share?
- **Taxation of international transactions**—Is the federal income-based tax system sustainable and administrable in a global economy? How should we tax the income of U.S. multinational corporations that is earned outside of the United States?
- **Tax system base**—To what extent should the basis of the existing system be changed from an income to a consumption base? Would such a change help respond to challenges posed by demographic, economic, and technological changes? How would reforms address such issues as

the impact on state and local tax systems and the distribution of burden across the nation's taxpayers?

**Promoting Economic
Growth in a Knowledge-
Based Society**

Many of the issues facing the Congress and the nation stem from complex and evolving domestic and global economies. Ultimately, sustaining and increasing economic growth over the longer term is essential to provide resources for a smaller cohort of workers to support an aging society. The nation's shift to a knowledge-based economy has underscored the importance of science and technology for economic growth and productivity and has placed greater emphasis on public policies that rely on market forces and competition. Over the longer term, the financial burdens facing the smaller cohort of future workers in an aging society would most certainly be lessened if the economic pie were enlarged.

The move away from the nation's traditional, manufacturing-based economy toward one characterized by the production of information, knowledge and services has contributed to a resurgence of productivity growth. Labor productivity growth accelerated from 1.6 percent per year in the early 1990s to 2.9 percent per year from 1996 through 2003.

Sustaining this relatively high rate of productivity will present challenges to policymakers. Because intellectual assets are the underpinning of a knowledge-based economy, investment in human capital is fundamental to continued growth. For policymakers, this shift requires greater attention to education and training, both for children and adults. New importance will need to be given to continuing education and training for adults, whose longer life expectancies will allow them to stay in the workforce longer. The shift to a knowledge-based economy also has implications for immigration policy. The emergence of technology-oriented industries has created growing reliance on workers from other countries, working either in the United States or in their home countries. In light of heightened concern for homeland security, the flow of workers into the country is being reassessed.

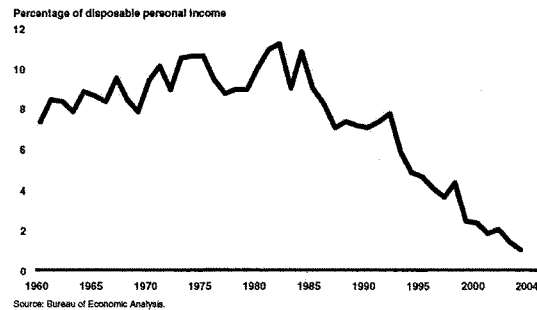
Other key factors that drive sustained growth in the changing economy include research and development expenditures, trade openness, and effective public and private infrastructure. Advances in science and technology in the United States, along with the nation's strong research and development infrastructure and intellectual property protections, have long ensured the United States a leadership position in the development and commercialization of scientific advances and have helped nurture

entrepreneurship and dissemination of information on new technologies. However, other nations are gaining in their research infrastructure and are beginning to challenge the preeminent position of the United States, challenging policymakers to further stimulate greater private research and collaborative scientific initiatives. Information technology advancements have contributed to substantial gains in U.S. productivity, but interconnectivity has also raised the potential for unauthorized access to personal and confidential data and created new vulnerabilities to the nation's critical operations and the infrastructures they support.

Effective public infrastructure is also an important underpinning for long-term growth. Increasing passenger and freight travel has led to growing congestion, and policymakers face the challenge of promoting more integrated, intermodal transportation systems. Transcending the boundaries of levels of government, as well as separate funding streams for different modes, will be essential if we are going to provide efficient movement of goods and people for a 21st century economy.

Underlying land use planning practices can both reflect transportation policies as well as further exacerbate mobility challenges. Specifically, sprawling development places undue stress on transportation systems, as well as on energy, water, and the environment. In many parts of the country, water shortages are expected over the next 10 years, which will necessitate difficult tradeoffs between competing claimants for this increasingly scarce resource.

The sustainability of economic growth and higher productivity levels also depend in large part on our national saving. Saving and investment drive the productivity growth that allows personal incomes to rise without accelerating inflation. However, national saving remains at both historically and comparably low levels. Historically, the most direct way for the federal government to increase saving has been to reduce the deficit (or run a surplus). Although the government may try to increase personal saving, results of these efforts have been mixed. For example, even with the preferential tax treatment granted since the 1970s to encourage retirement saving, the personal saving rate has generally steadily declined. (See fig. 7.)

Figure 7: Personal Saving Rate Has Steadily Declined

In recent years, personal saving by households has reached record lows, while at the same time the federal budget deficit has climbed. Accordingly, national saving has plummeted, but the economy has continued to grow, in part because more and better investments were made. That is, each dollar saved bought more investment goods, and a greater share of saving was invested in highly productive information technology. The economy has also continued to grow because the United States was able to invest more than it saved by borrowing abroad, that is, by running a current account deficit. However, a portion of the income generated by foreign-owned assets in the United States must be paid to foreign lenders. National saving is the only way a country can have its capital and own it too.

The persistent U.S. current account deficits of recent years have translated into a rising level of indebtedness to other countries. However, many other nations currently financing investment in the United States also will face aging populations and declining national saving, so relying on foreign savings to finance a large share of U.S. domestic investment or federal borrowing is not a viable strategy for the long run.

The foregoing suggests that changing economic trends and related forces will have important implications for federal policies and activities, as illustrated by the following questions:

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- **Immigration and workforce**—How can the United States balance immigration policies, such as worker and student visa programs, to address the need for workers with technical skills and the nation's need to maintain global preeminence in higher education, science and emerging homeland security requirements?
 - **Research and development**—Are different kinds of federal incentives needed to encourage greater private sector collaboration and nurture interdisciplinary research and development? For example, to what extent does the current research tax credit actually stimulate private sector research spending that would not have occurred otherwise?
 - **Transportation**—Do the existing tools and delivery mechanisms, such as existing trust funds dedicated to certain modes of transportation, have the ability to provide intermodal, efficient, cost-effective solutions to mobility and security challenges?
 - **Land use planning**—Can alternative federal approaches to transportation, land management and water policies be adjusted to better promote sustainable management of our nation's land and water resources? For example, given projected water supply shortages, is there a need to reassess the balance between urban expansion in water-scarce regions and the continuance of existing crop irrigation practices?
 - **Personal savings**—Could the myriad savings incentives (for example, IRA's, health savings accounts, education savings incentives, etc.) that complicate the current tax system be consolidated and simplified while promoting increased savings?

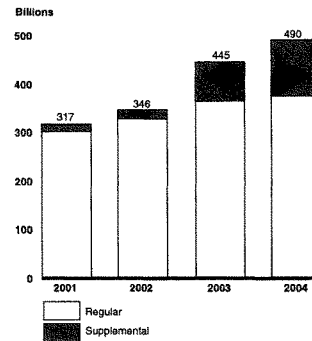
Changing Security Threats

The United States is militarily unchallenged and probably will be for the foreseeable future. Since the demise of the Soviet Union and the end of the Cold War, the United States has emerged as the dominant military, political and economic power in the world. Yet in the past 15 years, the world has experienced dramatic changes in the overall security environment. The focus has shifted from conventional threats posed during the Cold War era to more unconventional and asymmetric threats which take advantage of the individual freedoms we enjoy, as evidenced in the events of September 11, 2001.

In response to these changing threats, the Congress has taken a number of steps including (1) increased funding for the Department of Defense (DOD)

(See fig. 8.), (2) created the Department of Homeland Security (DHS), (3) provided increased funding for DHS and other federal agencies responsible for domestic homeland security, notably for border and transportation security, and (4) restructured intelligence activities. The Congress faces the difficult task of integrating and balancing fighting terrorism abroad and meeting the requirements for homeland security with other domestic priorities all the while protecting American liberties.

Figure 8: Growth in Budget Authority for Department of Defense Fiscal Years 2001-2004



Source: Office of Management and Budget, Budget of the United States Government, Fiscal Year 2006 (February 2005).

Note: Supplementals are for defense and other global war on terror.

While DOD has taken steps to meet short term operational needs, it still faces the fundamental challenge of determining how it will meet the longer term concerns of reorganizing its forces and identifying the capabilities it will need to protect the country from current, emerging, and future conventional and unconventional security threats. As DOD seeks to meet the demands of the new security environment, it continues to bear the costs of the past by maintaining or continuing to pursue many of the programs and practices from the Cold War era. Moreover, DOD faces serious and long-standing challenges in managing its ongoing business operations. Complicating its efforts are numerous systems problems and a

range of other long-standing weaknesses in the key business areas of strategic planning and budgeting, human capital management, infrastructure, supply chain management, financial management, information technology, weapon systems acquisition, and contracting. In fact, DOD alone has 8 of the 25 items and shares in the 6 cross-cutting ones on our recently-issued high-risk list.

Concerns about the affordability and sustainability of the rate of growth in defense spending will likely prompt decision makers to reexamine fundamental aspects of the nation's security programs, such as how DOD plans and budgets; organizes, manages, and positions its forces; acquires new capabilities; and considers alternatives to past approaches. To successfully carry out this reexamination, DOD must overcome cultural resistance to change and the inertia of various organizations, policies, and practices that became well rooted in the Cold War era.

The threat of terrorism will persist well into the 21st century. Terrorists are dispersed in loosely organized, self-financed, international networks, some of which are cross-national. Domestic terrorist groups remain a security threat, though currently to a much lesser extent than the international terrorist movement. We must fundamentally reexamine our approaches to terrorism and homeland security—the nature of the terrorist threat, its long-term impact, and the impact of our strategies. While most believe we are safer than we were on the day of the September 11 attacks, we still are not safe. As the Gilmore and 9/11 Commissions pointed out, the nation will never be completely safe and total security is an unachievable goal.

To adapt national strategies to address current and future threats to homeland security, it will be imperative to define an acceptable, achievable, and affordable level of risk. Security risks have been exposed in many aspects of normal life, with perhaps many of the greatest dangers posed in areas that Americans have simply taken for granted, such as air and water supplies, food production chains, information systems, airports and train stations, ports, borders, and shopping malls. However, we cannot afford to protect everything against all threats—choices must be made about protection priorities given the risk and how to best allocate available resources. While risk-based allocation decision making is still evolving, we must take a more systematic, reasonable and responsible approach to allocating resources.

Another crucial challenge to addressing security risks across the nation is establishing effective federal, state, and local government; private sector;

nongovernmental; and nation-state partnerships. The Constitution requires the federal government to "provide for the common defense" and to "repel invasions." Many would interpret those requirements to justify homeland security and related counterterrorism activities as an inherently governmental obligation. However, the vast majority of the targets that require protection are those owned by the private sector—critical infrastructure such as water and power sources and information systems. In addition, many of the emergency response and recovery capabilities are those with nonfederal or not-for-profit entities, such as public health facilities. Thus homeland security can only be accomplished through recognizing the interdependencies of federal, state, local, and private sector partners and the careful planning and integration of the roles and responsibilities of federal and nonfederal partners. For example, emergency response to a terrorist attack involving chemical or biological weapons will require effective coordination between federal, state, and local law enforcement agencies; other first responders; as well as public health agencies, affected hospitals, and laboratories. The challenge for the federal government is to design, select, and manage the various tools to encourage cost-effective integration to fully leverage scarce resources. For example, ensuring that critical information is shared, analyzed, integrated, and disseminated can help prevent or minimize terrorist activities.

The following questions illustrate the kinds of issues that we will face as the nation adapts to the changing threats to our national and homeland security.

- **Defense resource allocation**—How should the historical allocation of resources across services and programs be changed to reflect the results of a forward-looking comprehensive threat/risk assessment as part of DOD's capabilities-based approach to determining defense needs?
- **Defense support services**—What kinds of economies of scale and improvements in delivery of support services would result from combining, realigning, or otherwise changing selected support functions (e.g., combat support, training, logistics, procurement, infrastructure, or health care delivery)?
- **Homeland security risk**—What is an acceptable level of risk to guide homeland security strategies and funding?

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- **Critical infrastructure**—Are existing incentives and initiatives sufficient to support private sector protection of critical infrastructure they own, and what changes might be necessary? What cybersecurity technology can be applied to protect critical infrastructure from attack?
 - **Information sharing**—How can intelligence and information on threats be shared with other levels of government and other critical entities, yet be held secure?
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Governance Challenges

The government's capacity to address these trends and challenges is, itself, a 21st century challenge. The capacity of the system to address the emerging issues identified in these themes is predicated on a policymaking and management process that has sufficient foresight, information, integration, and management capacity to fully consider and act on emerging trends.

In part this is a question of time horizons. Policy action, or inaction, has implications far beyond today. How can policymaking institutions develop the capacity to consider the implications of actions or inaction for current as well as future generations? A longer-term perspective may be essential to keeping ahead of the "crisis curve," but it can also offer other benefits. If the time horizon for policy debates recognized longer-term forces, it would be easier for leaders to make the case for change to the broader public since it permits changes to be phased in over many years.

Whether it be future labor force trends or long-term health care costs, policymakers will need far better performance and cost information as they take on such broad-ranging issues. To continue to be a leading democracy in the information age may very well mean producing unique public sources of objective, independent, scientifically grounded, and widely shared quality information so that we know where the United States stands now and what the trends are on both absolute and relative bases—including comparisons with other nations. By ensuring that the best facts are made more accessible and usable by the many different members of our society, we increase the probability of well-framed questions and debates along with effective solutions. The stakes are high, including considerations regarding allocating scarce public resources, strengthening the economy, creating jobs, stimulating future industries, enhancing security, promoting safety, protecting privacy, strengthening our competitive edge, and sustaining the environment.

Addressing newly emergent issues and transformational change calls for a policy process that can look at broader issues across the narrow confines of individual programs, agencies, and tools. Many emerging issues are cross-cutting in nature and the policy process will have to be comprehensive enough to address these new tradeoffs. However, federal programs remain highly fragmented, reflecting a policymaking process that is overly stovepiped by agency and program, with insufficient focus on how individual programs contribute to overarching, crosscutting goals and missions. Although these individual programs address common or similar performance goals, they result in an overly fragmented delivery network and at times work at cross purposes. For example, federal food safety programs are carried out by 12 agencies with differing enforcement criteria and inspection practices. The Government Performance and Results Act (GPRA) provided for a governmentwide performance plan to address these crosscutting issues, but this plan has not yet been developed by the executive branch.

Many emerging problems span boundaries to involve federal, state, and local governments as well as private for profit and nonprofit entities. Whether it be homeland security or health care delivery, federal agencies and programs are increasingly reliant on coalitions of third-party providers, such as states, to address challenges. Moreover, such coalitions increasingly span national boundaries as many problems and issues are framed by international treaties and multilateral organizations. Often, a national, rather than strictly federal, solution is necessary requiring partnerships and concerted effort across sectors. Notwithstanding this increasing interdependence, major tensions exist as each actor in the network makes decisions with insufficient dialogue with program partners.

The foregoing suggests that public management systems and networks will have to undergo fundamental changes to respond effectively to the daunting challenges facing us. This calls for nothing less than a transformation in the people, processes, and technology used to address public goals and objectives. While some agencies are making major strides to transform their operations, in many cases the government is still trying to do business in ways that are based on conditions, priorities, and approaches that existed decades ago and are not well suited to addressing 21st century challenges.

For example, in many cases the government has not transformed how it motivates and compensates its employees to achieve maximum results within available resources and existing authorities. Even though people are

critical to any agency's successful transformation, define its culture, develop its knowledge, and are its most important asset, a number of agencies still try to manage their people through an outmoded system that (1) rewards length of service rather than individual skills, knowledge and performance; (2) automatically provides across-the-board annual pay increases, even to poor performers; and (3) compensates employees living in various localities without adequately considering the local labor market rates for these employees. To address these problems and provide the services the public expects, the federal civil service system must be reformed governmentwide, and this reform must be guided by a set of consistent principles, criteria, and practices.

Another example is the outmoded physical footprint of agencies, which reflects the failure to take advantage of opportunities provided by new technology and transportation to modernize operations. More than 30 federal agencies control about \$328 billion in real property assets worldwide, and maintain a "brick and mortar" buildings and/or office presence in 11 regions across the nation. But this organization and infrastructure reflects a business model and the technological and transportation environment of the 1950s. Many of these assets and organizational structures are no longer needed; others are not effectively aligned with, or responsive to, agencies' changing missions; and many others are in an alarming state of deterioration, potentially costing taxpayers tens of billions of dollars to restore and repair. The Congress and several agencies have recognized and begun to address this issue, but this financial liability still looms.

The following questions illustrate the kinds of issues that we will face in better aligning our governance system with the emerging challenges posed by broad sweeping changes:

- **National performance indicators**—Is the federal government effectively informed by a key national indicator system about the position and progress of the nation as a whole—both on absolute and relative bases compared to other nations—as a guide to helping set federal agency and program goals and priorities?
- **Crosscutting program integration**—How can agencies partner or integrate their activities in new ways, especially with each other? For example, how can the myriad federal food safety programs managed across several federal agencies be consolidated to better promote safety and the integrity of the nation's food supply?

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- **Improving partnerships**—What mechanisms might usefully bring together leaders across governments to address joint problems, perhaps through establishing commissions or other vehicles for promoting dialogue and action?
 - **Federal human capital reform**—How should the federal government update its classification and compensation systems to be more flexible, market-based and performance-oriented while at the same time incorporating safeguards to help ensure consistency and equity and prevent abuse of employees?
 - **Modernizing the federal footprint**—In a modern society with advanced telecommunications and electronic information capabilities, does the government still need 11 regions? What opportunities exist to more strategically manage the federal government's real property assets, such as disposing of excess federal facilities to make the federal portfolio more relevant to current missions and less costly?
 - **Transformational leadership**—Should we create chief operating officer or chief management officer positions with term appointments within selected agencies to elevate, integrate, and institutionalize responsibility and authority for business management and related transformation efforts?

Where Do We Go From Here?

We recognize that the process of reexamining the base of government will not be a simple or easy process—there are no “quick fixes.” Such a process reverses the focus that occurs in incremental reviews, where disproportionate scrutiny is given to proposals for new programs or activities but little or no scrutiny is given to those that are already in the base. Taking a hard look at existing programs and carefully reconsidering their goals and their financing is a challenging task. Reforming programs and activities leads to winners and losers. Given prior experience and political tendencies, there is little real “low-hanging fruit.”

The size of the fiscal challenge and the significance of the societal and economic changes worldwide means this kind of examination and the hard choices necessary to restore a sustainable fiscal path and modernize government may take a generation to address. Our history suggests that all major spending and revenue programs and policies need to be subject to periodic reviews; exempting major areas can undermine the credibility and support for the entire process.

Beginning the reexamination and review process now would enable decision makers to be more strategic and selective in choosing areas for review over a period of years. Reexamining selected parts of the budget base over time rather than all at once will lengthen the process, but it may also make the process more feasible and less burdensome for decision makers. And by phasing in changes to programs or policies that might otherwise have prohibitively high transition costs, the impact can be spread out over longer time periods. After all, our country, children, and grandchildren are counting on us to be both prudent today and effective stewards for tomorrow. We should not be satisfied with anything less.

Although reexamination is never easy, the effort is not without precedent. The federal government, in fact, has reexamined some of its programs and priorities episodically in the past. Programmatic reexaminations have included, for example, the 1983 Social Security reform, the 1986 tax reform, and the 1996 welfare reform. They have also included reforms such as the creation of the Department of Homeland Security and, most recently, the ongoing reorganization of the U.S. intelligence community, as this Committee knows so well. From a broader fiscal standpoint, the 1990s featured significant deficit-reduction measures adopted by the Congress and supported by the President that made important changes to discretionary spending, entitlement program growth, and revenues that helped eliminate deficits and bring about budgetary surpluses. States and other nations also have engaged in comprehensive reexamination exercises.

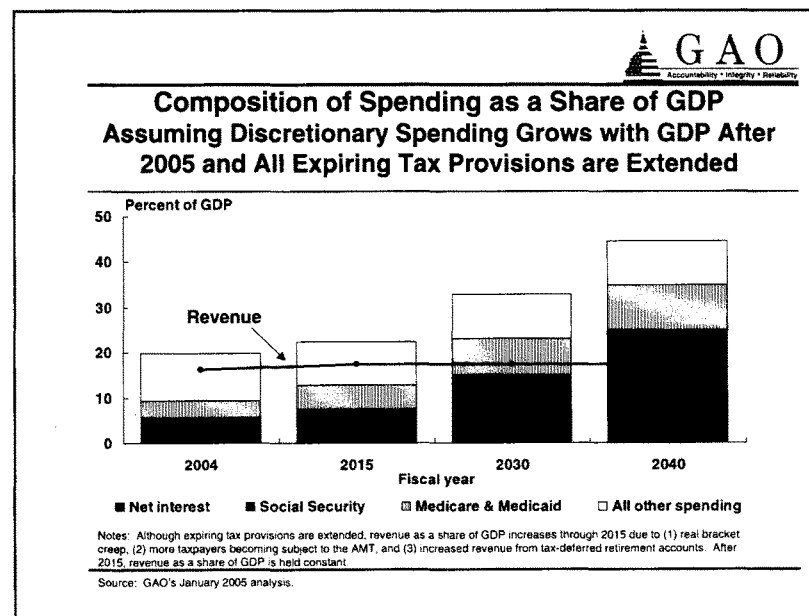
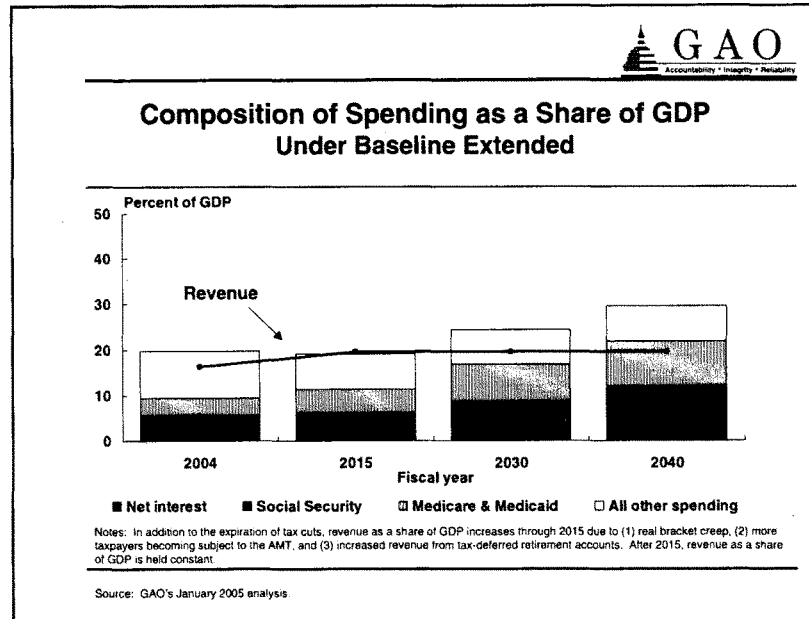
In our system, a successful reexamination process will in all likelihood rely on multiple approaches over a period of years. The reauthorization, appropriations, oversight, and budget processes have all been used to review existing programs and policies. Adding other specific approaches and processes—such as temporary commissions or executive reorganizations to develop policy alternatives—has been proposed. We would suggest that there is no single approach or institutional reform that can address the myriad of questions and program areas that need to be revisited.

Fortunately, GPRA and other results-oriented management laws enacted over the last 12 years have built a base of performance information that can assist the Congress and the President in this effort. In the last few years, OMB has been working to rate the effectiveness of programs under the program assessment rating tool (PART). There are also many nongovernmental sources of program evaluation and analysis. And, finally,

the Congress has its own analytic support—your staff and that of the congressional support agencies, including GAO. As always, GAO stands ready to assist the Congress as it develops its agenda and to help answer any of the questions the Congress wishes to pursue.

We hope that this new report will be used by various congressional committees as they consider which areas of government need particular attention and reconsideration, recognizing that while answers to these questions may draw on the work of GAO and others, only elected officials can and should decide whether, how, and when to move forward.

Chairman Collins, Senator Lieberman, and Members of the Committee this concludes my testimony. I would be happy to answer any questions you may have.





Strategic Plan Themes

- Long-Range Fiscal Challenges
- Changing Security Threats
- Increasing Global Interdependence
- The Changing Economy
- Demographic Shifts
- Science and Technology Advances
- Quality of Life Trends
- Changing Governance Structures



Generic Reexamination Criteria

• Relevance of purpose and the federal role

E.g., Have there been significant changes in the country or the world that relate to the reason for initiating it?

• Measuring success

E.g., If there are outcome-based measures, how successful is it based on these measures?

• Targeting benefits


E.g., Is it well targeted to those with the greatest needs and the least capacity to meet those needs?

• Affordability and cost effectiveness

E.g., Is it using the most cost-effective or net beneficial approaches when compared to other tools and program designs?

• Best practices

E.g., Is the responsible entity employing prevailing best practices to discharge its responsibilities and achieve its mission?




Twelve Reexamination Areas

MISSION AREAS

<ul style="list-style-type: none">• Defense• Education & Employment• Financial Regulation & Housing• Health Care• Homeland Security	<ul style="list-style-type: none">• International Affairs• Natural Resources, Energy & Environment• Retirement & Disability• Science & Technology• Transportation
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CROSSCUTTING AREAS

<ul style="list-style-type: none">• Improving Governance	<ul style="list-style-type: none">• Reexamining the Tax System
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Illustrative 21st Century Challenges: Demographic Shifts - Aging Population

- Social Security
- Labor Force
- Private Pensions
- Disability Programs
- Health Care Reform
- Health Care Financing
- Health Care Quality



**Illustrative 21st Century Challenges:
Increasing Global Interdependence**

- Financial Regulation
 - Financial Literacy
 - Workforce Retraining
 - Domestic Subsidies
 - Tax Enforcement
 - Taxation of International Transactions
 - Tax System Base
-



**Illustrative 21st Century Challenges:
Promoting Growth in a
Knowledge-Based Economy**

- Immigration and Workforce
 - Research and Development
 - Transportation
 - Land Use Planning
 - Personal Savings
-



Illustrative 21st Century Challenges: Changing Security Threats

- Defense Resource Allocation
 - Defense Support Services
 - Homeland Security Risk
 - Critical Infrastructure
 - Information Sharing
-



Illustrative 21st Century Challenges: Governance Challenges

- National Performance Indicators
 - Crosscutting Program Integration
 - Improving Partnerships
 - Federal Human Capital Reform
 - Modernizing the Federal Footprint
 - Transformational Leadership
-



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Washington, DC 20548

**GAO Responses to Post-Hearing Questions from Chairman Collins from the
Senate Homeland Security and Governmental Affairs Committee Hearing
Held on Wednesday February 16, 2005**

Transforming Government for the 21st Century

Question 1: *Your report notes that foreign and state governments have successfully used various tools or models to help them make challenging restructuring decisions and to cut ineffective government programs. What can we learn from the work of other governments? Please provide us with some examples.*

Response:

Several foreign governments have engaged in reexamination efforts. Although we have not examined these in depth, others have suggested that reexamination may take a number of years, as illustrated by performance-based budgeting and performance management reforms in the United Kingdom, New Zealand, Australia, Canada, and The Netherlands. Others also suggest that reexamination may include participation by working groups of central budget and departmental staff and external experts, as was the case with reconsideration (of selected programs in a budget cycle) reviews in The Netherlands. Also, others suggest that reexamination may yield budgetary savings, as followed from the program review exercises in Canada—which delivered \$18.8 billion in savings above previously planned reductions (cumulative over 3 years)—and in The Netherlands.

Experiences by various states indicate additional lessons. Reexamination may include various cutback and revenue strategies, as illustrated by states' use of targeted spending cuts, strict enforcement of budget ceilings, adopting targets to constrain spending, putting a greater focus on spending controls, tapping rainy day funds, delaying expenditures, and in some cases increasing taxes and fees. Reexamination also may lead to a change in service delivery, such as replacing direct delivery of social services with contracted-out services if there is an expectation of benefits (e.g., more efficient and effective delivery of services). Reexamination, more recently, has included identifying cost-saving opportunities through reprioritization efforts and/or efficiency commissions in states such as Arizona, Maryland, Virginia, and Washington; their efforts, however, are either too new or not yet fully implemented, or improvements so far are limited.

Question 2: *Your report discusses the need to transform federal agencies. You support creating a new position in the Defense and Homeland Security departments to guide this transformation. How would establishing a Chief Management Officer/Chief Operating Officer position help agencies transform themselves?*

Response:

As the Department of Defense (DOD), the Department of Homeland Security (DHS), and other agencies across the federal government embark on large-scale organizational transformations to address 21st century challenges, there is a compelling need to (1) elevate attention on management issues and transformational change, (2) integrate various key management and transformational efforts, and (3) institutionalize accountability for addressing management issues and leading transformational change.¹ As we have reported, a Chief Operating Officer (COO) or Chief Management Officer (CMO) may effectively provide the continuing, focused attention essential to successfully completing these multiyear transformations in large and complex agencies like DOD and DHS. In the case of DOD, sustained leadership is needed to maintain continuity over DOD's overall business transformation efforts. One way to ensure sustained leadership over DOD's business transformation efforts would be to create a full-time position for a COO/CMO. Such leadership would provide the attention essential for addressing key stewardship responsibilities, such as strategic planning, acquisition management, performance management, information technology, and financial management in an integrated manner while helping to facilitate the transformation process within DOD.² At DHS, we reported that the COO concept would provide a single organizational focus for the key management functions involved in the business transformation of the department, such as human capital, financial management, information technology, contract management, and performance management, as well as for other organizational transformation initiatives.³ We have also recently testified that a COO/CMO can effectively provide the continuing, focused attention essential to successfully complete the implementation of DHS's new human capital system, a large-scale, multiyear change initiative.⁴ Specifically, such a position would serve to elevate attention that is essential to overcome an organization's resistance to change, integrate the human capital system with various management responsibilities so they are no longer stovepiped, and institutionalize accountability so that implementation of this critical human capital initiative can be sustained.

¹ On September 9, 2002, GAO convened a roundtable of government leaders and management experts to discuss the COO concept and how it might apply within selected federal departments and agencies. See GAO, *Highlights of a GAO Roundtable: The Chief Operating Officer Concept: A Potential Strategy to Address Federal Governance Challenges*, GAO-03-192SP (Washington, D.C.: Oct. 4, 2002).

² GAO, *Department of Defense: Further Actions Are Needed to Effectively Address Business Management Problems and Overcome Key Business Transformation Challenges*, GAO-05-140T (Washington, D.C.: Nov. 18, 2004). DOD's approach to business transformation is also a new GAO high-risk area. See *High-Risk Series: An Update*, GAO-05-207 (Washington, D.C.: January 2005) for a discussion of the need for a CMO to help address DOD's business transformation challenges.

³ GAO, *The Chief Operating Officer Concept and its Potential Use as a Strategy to Improve Management at the Department of Homeland Security*, GAO-04-876R (Washington, D.C.: June 28, 2004).

⁴ GAO, *Human Capital: Observations on Final DHS Human Capital Regulations*, GAO-05-391T (Washington, D.C.: Mar. 2, 2005), and GAO, *Human Capital: Preliminary Observations on Final Department of Homeland Security Human Capital Regulations*, GAO-05-320T (Washington, D.C.: Feb. 10, 2005).

The specific implementation of such an approach, however, must be determined within the context of the particular facts, circumstances, challenges, and opportunities of each individual agency. In addition, certain mechanisms can serve to augment the COO/CMO position, and thus further strengthen and integrate business transformation efforts. These mechanisms include articulating the role of the COO/CMO in statute in order to make clear its broad responsibilities and qualifications, using performance agreements to clarify individual performance expectations, and setting a term appointment for the position to help ensure continuity and accountability over the long term. For example, the Congress could articulate the COO/CMO's qualifications in statute; such as the need for strong leadership skills and a demonstrated ability in managing large-scale change management initiatives. In addition, it is important to use clearly defined, results-oriented performance agreements accompanied by appropriate incentives, rewards, and accountability mechanisms for these positions. The COO/CMO's progress in meeting the terms of the performance agreements would form the basis of any performance bonuses, as well as any decisions on removal or reappointment of the COO/CMO. Large-scale change initiatives and organizational transformations require a long-term, concerted effort, and can take years to complete. Providing a COO/CMO with a term appointment of 5 to 7 years would be one way to help ensure that these long-term transformation initiatives are successfully completed. Finally, strong and continuing congressional oversight can help determine how best to elevate, integrate, and institutionalize key management and transformation responsibilities in federal agencies.

Question 3: *In your testimony, you discuss 21st century challenges facing the Departments of Homeland Security and Defense that include determining acceptable levels of risk and modernizing key business areas such as strategic planning and information technology. You also discuss the need to strike a balance between robust information sharing and the need to protect security. What lessons from the attempts these departments have made to tackle these challenges could help guide the new Director of National Intelligence as he or she implements the Intelligence Reform and Terrorism Prevention Act of 2004?*

Response:

Many of the challenges the overall intelligence community faces are similar or identical to the transformation challenges applicable to many other federal agencies, including GAO. These involve strategic planning and budgeting, organizational alignment, human capital strategy, and the management of information technology, finances, knowledge, and change.⁵ Managing risk and sharing information are part of the overall transformation challenge. In finding an appropriate national resource balance between homeland security and other priorities, an improved risk management framework for resource allocation and homeland security investments will be key. It will also require an improved set of performance and results measures to gauge our progress and consider the roles and responsibilities of the state, local, and private sectors. The intelligence community itself will need to move from a

⁵GAO, *Intelligence Reform: Human Capital Considerations Critical to 9/11 Commission's Proposed Reforms*, GAO-04-1084T (Washington, D.C.: Sept. 14, 2004).

culture of a “need to know” to a “need to share”. Experience shows that failure to adequately address a wide variety of people and cultural issues are at the heart of unsuccessful organizational transformations. Recognizing the people element in these initiatives and implementing strategies to help individuals maximize their full potential in the new environment are key to a successful transformation of the intelligence community and related homeland security organizations. Sustained and inspired leadership and persistent attention by all key parties will be indispensable to making lasting changes in the intelligence community.

We have found that a number of key practices and steps can help agencies undergoing broad-based transformations (e.g., DOD and DHS) change their cultures so that they can be more results oriented, customer focused, and collaborative in nature. Among these key practices is to establish a coherent mission and integrated strategic goals to guide the transformation.⁶ Embedding core values, such as the “need to share” principle, within the organization can help reinforce the new culture. Agencies’ performance management systems can be critical tools in helping embed those values. Establishing an effective communication strategy that builds trust, ensures consistency of message, and encourages two-way communication can help create shared expectations among involved parties. And, again, recognizing the importance of people in any organizational effort, relying on effective employee teams, incorporating employee feedback into new policies and procedures, and delegating authority to the appropriate levels of the organization can help build corporate ownership for the transformation itself.

Question 4: *We often face the question of what should be the role of the private sector in promoting homeland security. By latest estimates, 85 percent of our nation’s critical infrastructure is in private hands. The government has spent a lot of money improving protection for that infrastructure. How do you see the role of the private sector in homeland security?*

Response:

As the Committee knows, private sector actions are vital to the protection of the nation’s critical infrastructure. The private sector role was highlighted early on in the President’s National Strategy for Homeland Security. Our work on chemical facilities, seaport security, and air cargo also illustrates the importance of the private sector. The Environmental Protection Agency, for example, reports that 123 private chemical facilities located throughout the nation have toxic “worst case” scenarios where more than a million people in the surrounding area could be at risk of exposure to a cloud of toxic gas if a release occurred. The chemical industry, led by its industry association, has taken a number of voluntary initiatives to address security at facilities. However, voluntary efforts alone are not sufficient to assure the public of industry’s preparedness. We have recommended the development of a comprehensive national chemical security strategy.

The Committee may want to watch implementation of DHS’s new Interim National Infrastructure Protection Plan and its role for the private sector in homeland security.

⁶GAO, *Results-Oriented Cultures: Implementation Steps to Assist Mergers and Organizational Transformations*, GAO-03-669 (Washington, D.C.: July 2, 2003).

The plan presents a risk management framework for addressing threats, vulnerabilities, and consequences. It is designed to provide a roadmap for identifying critical infrastructure and key resources and assets, assessing vulnerabilities, prioritizing assets, and implementing protection measures. The private sector will be working with federal agencies to implement plans for critical infrastructure sectors. In addition, an issue highlighted in our recent 21st century challenges report is risk-based decision making. We have advocated the need to implement a risk management approach for prioritizing efforts and focusing resources. A risk management approach entails a continuous process of managing risk through a series of actions, including setting strategic goals and objectives, assessing risk, evaluating alternatives, selecting initiatives to undertake, and implementing and monitoring those initiatives. While that decision making is still evolving, I believe we should take a more systematic, reasonable approach to allocating resources and reducing costs for public and private entities.

Question 5: *Everyone seems to agree that information sharing is critical to mounting an effective homeland defense against terrorism, yet we have no way to measure it. How can we grade our country's progress toward improved information sharing since 9/11?*

Response:

GAO has issued several reports on the challenges of information sharing and highlighted successful information sharing practices. We have made numerous recommendations related to information sharing that can be part of an assessment process, such as effectively coordinating intelligence- and information-sharing initiatives of states and cities with federal entities, and within and between federal entities.

In addition, since 2002, legislation, various national strategies, and executive orders have specified actions for improving information sharing that can be assessed regarding the country's progress toward improved information sharing. For example, the Homeland Security Act of 2002 included specific mechanisms intended to improve information sharing, such as procedures for facilitating homeland security information sharing and establishing authorities to share different types of information. The National Strategy for Homeland Security highlighted federal actions to promote two-way information-sharing mechanisms. In August 2004, the President issued executive orders that strengthened terrorism information sharing through means such as requiring information-sharing standards and establishing a National Counterterrorism Center. Recently, as the Committee knows, the intelligence reform legislation called for initiatives such as establishing an information-sharing environment and an information-sharing council.

If a grade had to be assigned to the federal government's information sharing efforts, it would be "incomplete." Establishing an effective two-way exchange of information to detect, prevent, and mitigate potential terrorist attacks requires an extraordinary level of cooperation and perseverance among federal, state, and local governments and the private sector to establish timely, effective, and useful communications. While there has been a wide range of executive and legislative branch actions, significant challenges remain. For example, a great deal of work remains to

effectively implement the many actions called for to improve homeland security information sharing, including establishing clear goals, objectives, and expectations for the many participants in information-sharing efforts; and consolidating, standardizing, and enhancing federal structures, policies, and capabilities for the analysis and dissemination of information. The Director of National Intelligence and the Congress need to agree on an oversight mechanism to inspect the intelligence and information sharing process to ensure that requirements and plans for information sharing are working. The mechanism should identify intelligence produced by the gathering and analyzing agencies, determine which users should have received it, determine if the information was received by the users and if the dissemination process was timely and appropriate, and assess if the information was useful to the users.

Question 6: *Your report also highlights problems of overlap and duplication in the government's education grants programs. Access to higher education is a great concern in my home state and across the nation. Yet, as we increase our grant and loan programs for college, we see increases in tuition costs outstripping people's ability to pay. How can we evaluate the performance of federal education grant programs?*

Response:

The federal government uses a range of policies to assist students in financing postsecondary education: grants, loans, and an array of tax benefits, including tax credits, deductions, and tax-preferred saving. For the Congress to assess the performance of these policies, it must receive information about who these serve and with what impact. The Congress does not yet have this information available to it. Several questions likely to be important to the Congress remain to be fully answered, including: (1) Does the provision of student assistance—whether grants, loans, or tax benefits—result in levels of postsecondary attendance greater than would otherwise occur, and are some forms of assistance more effective at promoting attendance than others? (2) Do changes in the availability of assistance influence the types of institutions that students choose to attend, or affect whether students complete their postsecondary education? (3) How do postsecondary institutions respond to changes in the availability of federal student assistance? Have grant and loan increases, or the introduction of tax benefits, resulted in tuition increases or reductions in institutional aid to federally assisted students and, if so, to what degree? The Department of Education has undertaken little work to identify the link between these outcomes and the grant and loan programs it administers, and the Treasury and Education departments have not collaborated to provide the Congress with evidence about the impact of tax provisions. Determining how these policies are performing is difficult, but not impossible. Given the annual investment of billions of dollars—in outlays and revenues foregone—studying their effectiveness is warranted.

Question 7: *You have cited the tremendous advances in science and technology as one of the challenges facing our government. What do you see as the greatest opportunities for improving government that have been made possible by those advances?*

Response:

The potential for the government to harness recent advances in science and technology is well illustrated by the application of information technology (IT) to improve government programs. Use of IT solutions can alter the way citizens interact with government, making it easier for them to get information and assistance, identify and obtain services, file applications and taxes, and conduct other transactions. These changes will have significant implications for the type and location of property needed by the federal government in the 21st century. IT also provides the potential for opening the workforce to people who were previously barred by physical handicaps or geographic distance. Interconnectivity between various government systems enabled by IT can also lead to program efficiencies through greater information sharing. Relatedly, IT advances may also support the implementation of health care system-wide production and dissemination of medical outcome data, safeguards to ensure privacy, and increased measurement and reporting efforts. Additional opportunities associated with improved science and technology include securing our homeland's borders and critical infrastructures, modernizing major government operations like the Federal Aviation Administration's Air Traffic Control system, and advancing the precision of the Department of Defense's major weapon systems.

Question 8: *To facilitate the process of cutting wasteful programs, the Administration in their 2006 request has asked Congress to establish two program evaluation commissions: a sunset commission and a results commission that would look for ways to improve interagency coordination. We spoke briefly about these issues during the hearing. Once you've had further time to review these initiatives, could you please provide us with your views?*

Response:

Many departments and agencies were created in a different time and in response to problems and priorities very different from today's challenges. Some have achieved their one-time missions and yet they are still in business. Many have accumulated responsibilities beyond their original purposes. Others have not been able to demonstrate how they are making a difference in real and concrete terms. Still others have overlapping or conflicting roles and responsibilities. Redundant, unfocused, and uncoordinated programs waste scarce funds, confuse and frustrate program customers, and limit overall program effectiveness.

There is no single approach or institutional reform that can address the myriad of questions and program areas that need to be revisited. In our system, a successful reexamination process will in all likelihood rely on multiple approaches over a period of years. The reauthorization, appropriations, oversight, and budget processes have all been used to review existing programs and policies. Adding other specific approaches and processes—such as temporary commissions or executive

reorganizations to develop policy alternatives—has been proposed. As a reexamination unfolds, a combination of approaches may be needed.

The President's broad proposal to create a special temporary commission to conduct such a fundamental review of federal programs is one suggestion that merits consideration. As I have testified before,⁷ a commission can be a means to ensure the involvement of key players to help reach consensus on any specific proposals. Special temporary commissions have been convened to formulate recommendations for specific policy or functional areas. Such commissions can be appealing because they provide a safe haven for developing policy alternatives, often are bipartisan in nature, may involve both executive and legislative branch representatives, and typically include experts both within and outside of government. Most commissions are designed to address specific issues in a timely manner and then are dissolved.

While commissions can be promising, their ultimate success depends on the extent to which the Congress and the executive branch agree about the need for action, on the need to use a nontraditional approach to reach agreement or to develop a specific proposal, and on their general willingness to address the recommendations of such commissions. This can be seen in the differing results of some examples: Social Security reform (e.g., Greenspan Commission and Moynihan Commission), terrorism and intelligence reform (e.g., 9-11 Commission), military base realignment and closures (e.g., BRAC Commission), and Medicare (e.g., Breaux Commission).

The President's proposal for a results commission would call for "expedited procedures" to approve a reform commission's recommendations. Such a feature raises important issues related to the roles of the Congress and the executive branch in developing restructuring proposals. In the past, the Congress has provided the President with executive reorganization authority to propose and gain fast-track consideration of changes in structures and responsibilities of federal agencies and programs. However, such authority has been progressively limited over the years. The fundamental issue raised by the expedited procedures provisions is whether and how the Congress wishes to change the nature of its normal deliberative process. The Congress may want to consider different tracks for proposals that propose significant policy changes versus those that focus more narrowly on government operations.

Regarding a presidential proposal for a Sunset Commission, proposals have been made to institute across-the-board provisions terminating all existing programs after a certain number of years to trigger their reexamination. Although numerous specific programs contain fixed-period authorizations that are like sunset provisions, such as the federal highway funding and the Temporary Assistance for Needy Families (TANF) programs, a broad federal sunset law has never been adopted. Concerns about this approach include the burden of a crosscutting provision and the lack of targeting those programs most in need of reexamination. In addition, some have noted that fixed-period authorizations are, in effect, sunset provisions. The reauthorization process can offer the same opportunity for reexamination—and if appropriations are not forthcoming in the absence of a reauthorization, then fixed-term authorizations effectively constitute sunsets.

⁷ GAO, *Executive Reorganization Authority: Balancing Executive and Congressional Roles in Shaping the Federal Government's Structure*, GAO-03-624T (Washington, D.C.: April 2003).

Response to Question from Senator Lieberman Regarding Economic Growth Assumptions in GAO Simulations

GAO's simulations and related charts are based on a standard economic growth model that incorporates feedback from budget surpluses or deficits. Nonfederal and federal saving together compose national saving, which influences investment and the nation's capital stock. Capital combines with labor and total factor productivity to determine the size of the economy in the next period, and the process continues. Accordingly, GAO's model does not contain an assumption about economic growth. Rather, economic growth in each simulation is a function of the policy choices that are modeled.

The assumptions underlying our simulations are as follows:

- **Baseline extended** follows CBO's January 2005 10-year baseline projections which assume that discretionary spending grows with inflation and tax provisions scheduled to expire will actually do so. After 2015, discretionary spending is assumed to grow with the economy, and revenue is held constant as a share of GDP at the 2015 level of 19.6 percent.
- **Discretionary spending grows with GDP after 2005 and all expiring tax provisions are extended** follows CBO's January 2005 10-year baseline projections except that discretionary spending grows with the economy after 2005 and all expiring tax provisions are extended. After 2015, revenue is held constant as a share of GDP at the 2015 level of 17.4 percent.
- After the first 10 years, in both simulations Social Security and Medicare spending is based on the March 2004 Trustees' intermediate projections. Medicaid spending is based on CBO's December 2003 long-term projections under mid-range assumptions. Social Security and Medicare benefits are paid in full after the trust funds are exhausted through borrowing from the general fund to meet any payroll tax shortfall.

For labor force growth we follow the intermediate assumptions of the Social Security and Medicare Trustees. We assume that total factor productivity grows at 1.4 percent per year on average (CBO's January 2005 short-term assumption and the long-term average from 1950-2004). Nonfederal saving is assumed to increase gradually over the first 10 years to 16.3 percent of GDP, the average nonfederal saving rate from 1995-2004.

Under these assumptions, the resulting average real growth rate in our "Baseline extended" simulation is 2.0 percent. In our "Discretionary spending grows with GDP after 2005 and all expiring tax provisions are extended" simulation, the resulting average real growth is 1.3 percent. In both simulations, real economic growth declines over the period as federal deficits increase and net national saving declines.

Additional detail on the assumptions underlying the long-term model can be found on GAO's web site at <http://www.gao.gov/special.pubs/longterm/simulations.html>.